COMMERCIAL LAW

By
SAMUEL WILLISTON, LL.D.
Dane Professor of Law in Harvard University

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PREFACE

HOW much law should a banker know? While this is a difficult question to answer with any degree of finality, the American Institute of Banking, by virtue of its experience of over a quarter of a century in teaching some of the phases of this subject, is convinced that bankers may be of greater usefulness to their institutions if they are acquainted with the general principles of law back of the daily routine of the bank. In this study there is no attempt to usurp the place or function of the lawyer in the banking world; his place is fixed and essential to sound bank operation and management.

The outline of the text material in the field of Commercial Law was first prepared for the Institute many years ago by Samuel Williston, Professor of Law in the Harvard Law School. Suggestions for additional material were offered from time to time by lawyers who were teaching Institute courses, and in this manner the text was augmented by contributions from those directly interested in legal instruction from the point of view of Institute students. Richard W. Hill, a member of the New York Bar and National Secretary of the American Institute of Banking, was most helpful in coordinating the suggestions offered and in adapting them to Institute needs.

In 1928 the assistance of Samuel Williston was again sought in connection with a possible revision of the Commercial Law textbook and he consented to rewrite the book. In preparing the material for this new text Dr. Williston has been assisted by James M. Landis, Professor of Legislation in the Harvard Law School.

Dr. Williston was at one time a teacher in Institute classes and since then has maintained his interest in the organization. He is recognized as an outstanding authority in the legal world.

This textbook thus represents the teaching experience of the Institute and the opinion of one of the outstanding teachers of law as to what the Institute course in Commercial Law should embrace.

HAROLD STONIER
National Educational Director

WHO IS A BANKER?

A SUCCESSFUL BANKER is composed of about one-fifth accountant, two-fifths lawyer, three-fifths political economist, and four-fifths gentleman and scholar—total ten-fifths—double size. Any smaller person may be a pawnbroker or a promoter, but not a banker.—George E. Allen

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COMMERCIAL LAW

Introduction

THERE are two great systems of law in use among civilized peoples today, the Roman or civil law, and the English or common law. The Roman law prevails in practically all the countries that are non-English speaking. As the name implies, it originated in Rome, and as the Roman Empire absorbed the ancient world, it carried its legal system and its legal institutions throughout the then known world. About 530 A. D. the Roman law was codified under the direction of the Emperor Justinian. This codification still exists and is known as the Corpus Juris Civilis or the code of Justinian. With the fall of the Roman Empire various barbaric systems of law held sway for a time, but after the twelfth century the Roman law continued to gain ascendancy over the various competing systems of law until it became recognized as the basis of the legal systems throughout Europe.

Beginning with the code Napoleon in France, the various continental countries drew up codes, modeled on the old Roman code, that today constitute the basis of their law. From Europe the Roman law was carried to countries settled by citizens from continental Europe —to the South American countries, to Central America, to the French, Spanish, Portuguese, and Dutch colonies. The colonies, in turn, developed codes modeled on the

Roman law. The Roman law also became the system of law in Louisiana when it was under the control of the French and Spanish. Even today Louisiana possesses a code based upon Roman law principles, and its law at the bottom is civil law though greatly modified by the introduction of common law principles.

Common Law—The common law, spoken of as "common" because it was common throughout England and because it was the law administered by the king's judges as opposed to the local customs and law administered by the manorial courts of feudal England, originated in England in the thirteenth century. Its form of development was quite different from that of the Roman law. There was no old and established body of legal doctrine which, like the Roman law, could be received and made the basis of the law of a nation. Instead the common law grew out of the decisions of the early judges in the cases that came before them, decisions that formed the basis for legal rules to be applied to similar situations. As such the content of the common law was mainly decisional. Common law lawyers always looked for their rules of law to decided cases rather than to any such codification of law as existed in Roman law countries. Gradually textbooks were written setting forth these principles of law, and in this fashion there was built up a body of legal principles which became known as the common law.

Equity—In the early days of the development of the common law, there was a tendency on the part of

law judges to make the system very rigid and formal. If a litigant could not bring his plea for relief within the four corners of an existing remedy, he was helpless. The litigant would then turn to the king who, in theory, was the fountain of justice. If the case was a meritorious one despite the fact that no legal remedies were available, the king, acting through the chancellor, would intervene and give the necessary relief. This intervention through an appeal to the chancellor for equity became quite common, and the chancellor in turn developed a system of legal rules for the administration of these equitable remedies known as equity. Thus, side by side with the development of common law, there came a corresponding development of equity to supplement and correct the deficiencies of the growing legal system. Both systems are law in the broad sense, but one system is spoken of as equity to distinguish it from law in the sense of those principles and rules administered by law courts. Thus England, in the seventeenth century, had two classes of courts, law courts and equity courts, to administer the two different types of law.

American Law—The colonists who came to this country in the early days brought with them the system of law which had been developed in England. Hence the common law became the law of America, and in administering law in this country American judges looked to the decisions of the English courts to discover the principles of the common law. The two systems of law and equity generally became a part of America's

legal heritage. The American revolution and the acquisition of independence made little change in this respect. Courts went on administering the law as they had theretofore administered it, based on the common law of England, modifying it only so far as necessary to fit in with our distinctly American institutions. The distinction between law and equity remained although with much modification. Some states still have a system of separate courts for the administration of law and equity. However, most of them administer law and equity in the same court and by the same judge, who maintains the distinction between law and equity by having a separate law docket and a separate equity docket, and by applying equitable principles to the decision of equity cases and legal principles to the decision of common law cases. A few states have sought to fuse the two systems, but distinctions between law and equity still remain.

Legislation—In addition to the judicial development of the common law, there has been a development of law by legislation. Rarely has legislation attempted to deal with a large branch of the law and remodel it as a whole. Usually statutes are passed to effect specific reforms and specific changes, to alter legal rules developed by judicial decisions, and to make new ones. A statute has the power of overriding any pronouncement of law made by a judge, so far as the future is concerned, and legislation thus becomes a powerful instrument in the development of law. The statute books of any one of our states are enormous, but they are small in comparison with the reports of the decisions of any one of

our state courts. Thus, in the main, the greater portion of our law is still decisional, that is, to be found in the reports of actually adjudicated cases.

Uniform Legislation—As we know, the country is divided into forty-eight states with the Federal Government over them. However, the powers of the Federal Government are quite limited, consisting only of those set forth in the Constitution of the United States. When the Federal Government acts within the scope of these powers, its action is supreme and represents law throughout the country. The great field of law, however, lies outside the scope of action by the Federal Government, and within its own borders each state is supreme. Both the statutes of a state and the pronouncements of its highest courts are the supreme law for that state. Consequently there is a law of New York, a law of Pennsylvania, and a law of every other state.

Although the laws of the states are essentially the same, being founded on the common law, they have various minor differences. To do away with variations in state laws upon subjects of commercial concern, the device of uniform legislation has been employed. Uniform legislation means the framing of a uniform statute and its adoption by state legislatures. Many uniform laws, which we shall have occasion to examine later, have been adopted in this manner, although few have been adopted by all the states. Despite the adoption of uniform legislation, the interpretation of these laws has not always been uniform even in the courts of the states that have adopted them.

Sources of the Law—From this brief consideration of the development of the law, it will be seen that the body of rules and principles which we know as the law has had many sources. It has developed during the course of time and is still in the process of development. New cases arise, for the solution of which there may be no definite single principle, and the principle for their solution must be developed in the same manner in which the earlier principles of law were developed. It has been truly said that the law must be stable but that it cannot stand still. It must be stable in the sense that it must be predicable; men must be able to determine in advance what their legal rights and obligations are. But it is also true that old rules, which were developed for a different stage of civilization than that in which we live, must be sloughed off, and new rules must be developed. Every important advance in our economic life brings with it new law. The railroad, the steamboat, electric light and power, all have forced courts to make new law. The airplane is in the process of doing so.

Where and how, we may ask, do courts find existing law and of what materials do they make new law? The sources of law are numerous. Constitutions and statutes form one important source of law. Judicial decisions constitute another, for common law countries follow the rule of stare decisis, namely, that one decision lays down a binding rule for the decision of a similar case. This rule, however, is not inflexible, and any court will overrule an earlier decision when it is convinced of the inadvisability of continuing a rule of law it has previously laid down. Custom is an important source of law. The

old motto that custom makes law is true to a considerable degree. Our present law of negotiable instruments is largely the result of the incorporation into judicial decisions of the customs which governed merchants in dealing with negotiable paper. The mining and water law of the western states is largely the outgrowth of custom. Prevailing ethical, social, and political ideals represent another source of law, for in the absence of other sources of law judges often draw upon their conceptions of what should be law and thus make law by deciding cases. Textbooks and treatises may also be considered sources of law. They are not authoritative sources in that the rules laid down will be binding upon any court, but rules of this nature may have a persuasive force.

Where to Look for Law—When we seek to discover what rule of law will govern a particular set of circumstances, we generally look first to the statutes and to the decisions of the state in which the transaction occurred. Digests of the decisions help us to locate those that will govern the case in point. If we can find no statute or controlling decision, we turn to the decisions of other states which, though not controlling, will have much influence; or we may turn to a textbook which sets out the rules of law and supports the statements in the text by giving the decisions of the courts.

When there is no controlling decision of our own state court to cover the case in question, we are often faced with one of two situations. In the first place, we may find that the decisions of other state courts are in

conflict, that is, that some states lay down one rule and others another. Here our problem becomes one of attempting to persuade our court to adopt that rule which we favor, or, if our case has not yet reached the point of actual litigation, to decide what rule will probably be adopted by the court if and when it is called upon to adjudicate the case. In the second place, we may find that there is no governing rule of law to be found in any decision. Here the problem is one of persuading the court to adopt a certain rule. Analogous cases are adduced and seemingly opposing cases differentiated. Considerations are advanced to illustrate the reasons for adopting the rule urged. The consequences of the rule urged are examined to show that they are in harmony with the general trend of legal obligations.

Illustration—Suppose that you live in New Jersey near an airport. Ascending and descending machines pass over your premises within four or five hundred feet of the ground. The noise irritates you and you fear that an airplane may fall and injure you or your children. You wish to have this flying across your property stopped, and you want to ascertain your rights. A search of the statutes of the United States and New Jersey reveals nothing on the point. A search of court decisions also reveals nothing, although you find intimations both ways. A search of textbooks on airplane law gives only suggestions or the individual views of the writers who differ.

You are familiar with the general doctrine that you can eject a trespasser from your land and recover

damages from him or get a court order to prevent continued trespassing. But does this flying constitute a trespass on your land? You recall the old maxim to the effect that the owner of land owns everything below it as well as up to the sky, but that statement was in vogue before the days of airplanes and you doubt its applicability to modern conditions. If you could enjoin the airplanes from crossing your land, neighboring property owners could do the same, with the result that the airport could be put out of business. What limit should the court set? Could you enjoin the flying below five hundred feet but not above? On the other hand, what about the applicability of the doctrine of acquiring rights by prescription to a case of this kind? This doctrine of prescription may be illustrated by the following example.

A, B, and C live in neighboring houses. A and C stretch a clothes line from A's window to C's window across B's backyard. This act constitutes a trespass upon B's property, but if A and C continue the practice for twenty years, they will have acquired by prescription a right to continue it permanently. Similarly, if the airplanes continue to fly across your land for twenty years, will they have acquired a right which would prevent you from erecting a twenty story building on your land? In the case of the clothes line, B could have cut it down at any time and thus actively interfered with the acquisition of the right, whereas it would be unreasonable to require you to erect an obstruction on your land to prevent a right of passage from being acquired five hundred feet above it. These are some of the considera-

tions which will have to be taken into account by a court when deciding a question of this nature. When laying down a rule to govern an entirely new situation, the court will have to draw upon existing rules of law in different fields.

Who Knows the Law—It is apparent that it may be extremely difficult to determine the law governing a particular case. There may be a definite rule in existence, but with the sources of the law scattered as they are it may be difficult to discover the rule. If no rule exists, there is the problem of determining what a court will probably decide when faced with a particular case. When we speak of the law in this sense, we mean our guess as to what a court will decide when called upon to judge our case. Sometimes these "guesses" can be made by a lawyer with great certainty, while at other times he must necessarily be very cautious in giving his opinion. Courts themselves are often divided in their opinions when deciding cases. It is not infrequent for the Supreme Court of the United States to decide a case by the majority of one vote, four of the nine justices dissenting. The decisions of inferior courts are constantly being reversed by appellate courts because of divergent views held by these courts as to what is the law. In view of these uncertainties, it may be an extremely difficult matter to determine the law in advance of a court decision. Consequently one should not lose respect for a lawyer simply because he is not always ready to give a definite answer but frames his reply in an opinion beginning, "It would seem that the law in

this case would be . . ." He is a wise lawyer who refuses to be definite when he knows that he cannot be so.

The Court System—There are two systems of courts in each state, the federal courts and the state courts. The federal courts have control of only a limited class of cases, in general of two types, namely, those in which a federal right is involved and those which consist of suits involving more than $3,000 between citizens of different states. Such suits may be brought originally in a federal court; if they are brought in a state court, they may be removed to a federal court at the request of the defendant. Federal rights consist of those rights which arise under the Constitution or laws of the United States, such as rights in admiralty, bankruptcy, patents, copyrights, or constitutional claims. The lowest federal court is known as the district court; each state has at least one federal district court. From the district court an appeal lies to the circuit court of appeals. There are ten circuit courts of appeals, and the country is divided into ten circuits to correspond to the number of courts. From the circuit court of appeals an appeal lies, in a limited class of cases, to the Supreme Court of the United States in Washington.

Each state also has its own system of courts. The lower courts of original jurisdiction may be of various types, some having jurisdiction only over claims under a certain amount and others having a general jurisdiction. In some states appeals from these courts lie to the highest court of the state, commonly known as the supreme

court of the state. In many states, however, there is an intermediate appellate court to which the case must first be appealed before it can go to the supreme court. In a very limited class of cases, usually where a federal right is in issue, appeals will lie from the highest court of a state to the Supreme Court of the United States. The whole question of when and how an appeal lies is a complicated one and varies with the court structure in each state.

CHAPTER I
Contracts—Mutual Assent

WHAT is a contract? Simply a promise or a set of promises which the law enforces as binding. This definition deals with two ideas, physical promises and the legal effect of these promises. Hence a study of the law of contracts and of the formation of contracts is concerned primarily with the question of what promises are binding. A man may make all sorts of promises; but when has he the right legally to change his mind and when will he be liable in damages if he fails to do as he agreed?

Classification

Express and Implied Contracts—In contracts there are certain terms which the student will find mentioned repeatedly and with which he should be familiar at the outset. For example, there are express contracts and contracts implied in fact. An express contract is one which is expressed in words, either oral or written. A contract implied in fact is one the terms of which are to be gathered by implication from the acts of the parties and from the circumstances surrounding those acts; all the elements necessary for the formation of a contract are present, but the agreement has not expressly been put into words. If A says to B, "I will sell you this watch for $50" and B replies, "I will buy your watch at that price," there is an express contract. But

suppose that A steps into a taxi and simply says to the driver, "Take me to the Union Station." The driver says nothing but takes A there. Here we have an example of an implied contract. By his conduct A impliedly agrees to pay the customary rate for the distance carried. Contracts implied in fact must also be distinguished from contracts implied in law. The latter, which are more properly termed quasi-contracts, will be discussed in detail in Chapter VII.

Formal and Informal Contracts—Contracts are either formal or informal. There are three kinds of formal contracts recognized in our system of law: (1) contracts under seal; (2) recognizances (or bonds, as they are sometimes called), which are acknowledgments made in court of an obligation to pay a certain sum subject to the condition that upon performance of a specified act the obligation shall be discharged; (3) negotiable instruments. Informal contracts, also called simple or parol, include all contracts not embraced in the three classes of formal contracts. They may or may not be in writing. The term parol is somewhat ambiguous. Sometimes it is used to mean an oral contract as opposed to a written contract, while at other times it is used to differentiate simple contracts from the three classes of formal contracts.

Unilateral and Bilateral Contracts—Contracts are classified as unilateral and bilateral. A unilateral contract imposes obligations on one party only. In a bilateral contract obligations are imposed on both

parties. Suppose that A promises to pay B $5 if B finds A's watch. By finding the watch B will complete the contract and A will be bound to pay him. On the other hand, B has promised nothing, and he is under no obligation to find A's watch. Unilateral contracts such as this are very common. Suppose, however, that A promises to pay B $5 if B promises to mow A's lawn, and B promises to mow A's lawn. A contract is formed by the exchange of the promises. B is under an obligation to mow A's lawn, while A is under an obligation to pay B for the mowing upon completion of the task. The obligations here are mutual, and the contract therefore is bilateral. In a unilateral contract a promise is usually given in exchange for an act, while in a bilateral contract promises are exchanged by the parties to the contract. Most important results arise from the distinction between a unilateral contract and a bilateral contract.

Void, Voidable, and Unenforceable Contracts—Contracts are also divided into void, voidable, and unenforceable contracts. Strictly speaking, a void contract is no contract at all. Contracts are usually void because of statutes declaring them void. A voidable contract exists where a party has the power to act in such a manner as to avoid the obligations created by the contract. The case of an infant who contracts for the delivery of a Packard automobile offers a good illustration of a voidable contract. The law gives the infant the power to avoid the contract. If he chooses, he may refuse to accept delivery of the car without being liable

to a suit for breach of contract; on the other hand, by tendering the purchase price, he may compel the dealer to perform his promise to deliver the car. An unenforceable contract is, in itself, a perfectly good contract, but because of some rule of law it cannot be enforced. For example, if A agrees orally with the owner of 115 Broadway to buy the property for $1,000, the contract is not enforceable, because under the Statute of Frauds, as we shall see later, any contract for the sale of real property must be in writing.

Executory and Executed Contracts—An executory contract is one which has not been performed on either side. The term is also applied to a contract where one party has performed and the other has not, although properly speaking such a contract is executed on one side and executory on the other. An executed contract is one which has been fully performed by the parties on both sides.

CONTRACTS UNDER SEAL

Contracts under Seal—There are two ways of making a promise binding, and unless the promisor fulfils the requisites of one or the other of these two ways his promise will not be binding. The first relates to the form in which the promise is made; the second relates to the substance of the transaction, irrespective of the form. The first concerns formal contracts under seal; the second concerns simple or parol contracts. The way to make a promise binding by virtue of its form is to

put it in writing, attach a seal to the writing, and deliver it. People sometimes think that a written promise is binding in any event, or that a promise which is not in writing is not binding in any event. Neither of these suppositions is true. A promise is not binding merely because it is in writing; it is necessary that something more shall be done. Not only must it be written, but a seal must be attached in order to make the promise binding by virtue of its form. Every one is familiar with the common ending in certain contracts, "Witness my hand and seal," that is, my signature and seal.

What Is a Seal?—Originally a seal was made with sealing wax stamped with a crest, initial, or whatnot. Such a seal is still sufficient for formal contracts, but the kind of seal commonly used today is simply a wafer attached by mucilage to the writing. The seal used by corporations and notaries consists simply of an impression made on paper without the attachment of any foreign substance. Any one of these methods of sealing a promise is good. In most states a written or printed scroll with the letters "L.S." written or printed within, or the word "Seal" written or printed, may also be considered a seal if so intended. It may seem a ridiculous formality for the law to attach importance to this lapping a wafer and attaching it to the end of a writing. In a way it is ridiculous, but it is desirable to have some simple method by which a promise may be made binding. One method is as good as another so long as it is an easy method, and attaching a seal is an easy method of making a promise binding when desired.

Delivery—The second requisite for the formation of a contract under seal is the voluntary delivery of the writing. Delivery to the promisee is good, but there may also be delivery to a third person, not the agent of the promisor, for the use of the promisee. In the latter case the contract is effective and irrevocable from the time of its delivery to the third person, not from the time of its delivery to the promisee by the third person. When a contract is delivered to a third person for delivery to the promisee upon the happening of a certain event, this act is called delivery in escrow. Until the event has happened the contract is not effective, even though the promisee may by fraud or otherwise acquire possession of the written contract, nor can the promisor recall the contract before the happening of the event. In some states delivery in escrow is used in the case of contracts for the sale of land. By delivery of the deed in escrow to a responsible party, the purchaser is assured that he will obtain the deed on payment of the purchase price; if the price is not paid, the seller may reclaim the deed.

Change by Statute of the Law as to Sealed Contracts—In this country there has been a certain amount of hostility to the law of sealed instruments. There are many technical rules governing the enforcement of rights under sealed contracts, and it has been thought, with reason, that by their technicality these rules promote injustice. However, the rule that a seal makes a promise binding is a desirable rule. A simple contract requires consideration to make it binding, and

consideration naturally precludes the assumption that the promise is purely gratuitous. To make a gratuitous promise binding, therefore, it is necessary to use some device as evidence of this intent, and the seal serves such a purpose. It would be better to abolish by statute the undesirable incidents of sealed contracts than to destroy totally the legal effect of a seal. As a matter of fact, in many states the distinction between sealed and unsealed contracts has been totally abolished. In a number of other states the common law rule has been changed by the enactment of statutory provisions to the effect that sealed contracts shall be presumed to have been made for a sufficient consideration. This is only a presumption, however, and lack of consideration may be affirmatively proved in such states even in the case of a sealed instrument. So, in these states a gratuitous promise under seal would not be binding.

SIMPLE CONTRACTS—MUTUAL ASSENT

Requisites of Simple Contracts—Sealed contracts are comparatively easy to understand. Simple contracts, which are promises made binding by virtue of their substance rather than by their form, are more difficult to understand and are more complex, although they are called simple. They are also much more common than sealed contracts. A simple contract is a promise or a set of promises to which the parties have assented and for which a price called consideration has been paid. So long as one does not attach a seal to his signature, he may promise as much as he wishes, orally or in writing,

and then say that he does not care to keep his promise, provided he withdraws his promise before he has been paid for the promise and before there has been an assent by the promisee to the terms of the transaction. Mutual assent and consideration are the requisites of simple contracts.

Intent to Contract—Intention, as we ordinarily understand the term, plays little part in the law of contracts. In order to create a contract, it is not at all necessary that the parties possess an intention to assume a legal obligation. Rarely do parties have such an intention. Instead there is generally merely an exchange of promises or the inducement of action by the party to whom the promise is made. In order to determine whether there is a contract, we need not ask whether the parties intended to assume a legal obligation provided the necessary elements of mutual assent and consideration are present. On the other hand, if the parties to an agreement intend that no legal obligation shall attach to their agreement, no contract will be formed. Thus if two persons in jest go through a marriage ceremony and both thereafter treat the matter as if no ceremony had ever been performed, no contract of marriage will have been formed. Similarly, if an instructor on leaving the lecture room should be met by a sudden downpour of rain and should remark that he would give $10 for an umbrella, a student who offered him an umbrella could not claim the money. A reasonable person would realize that such an offer was made jokingly and that there was no intention to as-

sume a legal obligation. However, if similar language, though actually used in jest or in anger or by way of a boast, would be understood by a reasonable person as a promise to do something in return for the requested exchange, a contract would be formed and what the speaker's actual intention had been would be entirely immaterial.

Offer and Acceptance—Mutual assent is manifested by an offer and by an acceptance of the offer. Two persons are not apt to express the same proposition at the same time; one makes a proposition, and if a contract is to result, the other assents to it. An offer may be made to one or more specified persons, or in a general way to any one who will do what the offer requests, as in the case of an offer of a reward. An offer is a promise, but it is a promise conditional on the performance of an act or on the return of a promise by the other party. The offer will fall into one or the other of the two main divisions of simple contracts, namely, unilateral or bilateral, depending on whether the offer asks for an act or for a promise.

Illustrations—Suppose that A says to B, "If you will spade up my garden, I will pay you $2 a day." A is making an offer to form a unilateral contract. He is asking B to spade up the garden—not to promise to spade it up but to do it—and when B has done it, he can hold A liable on his promise to pay B $2 a day. The promise will have become binding because A has been given the payment he asked for in his promise.

Now suppose that C says to D, "If you will agree to work for me this next month, I will pay you $100," and D says, "All right." This is a bilateral contract. C is asking D, as the price of C's promise, not to work but to agree to work, and D has promised to do so. To say "I accept" is always sufficient acceptance in the case of a bilateral contract where a promise is requested. But if C says to D, "I will give you $1 if you will take this book to my office," it will not make a contract if D says, "I accept." C said that he would give D $1 if D took a certain book to C's office, and nothing but D's taking the book there will form a contract. The offeree must always do what the offeror asks him. If an offeror asks for a promise, any form of words indicating assent is sufficient, because it would mean, in effect, "I consent to make the promise you specify in your offer."

In simple contracts the form of wording is immaterial. Any plain language is sufficient for an offer, and it does not matter whether the person addressed says, "All right," or "I accept your offer," or in what form he expresses his assent. The question is, does he express assent? The offeror may name any price he chooses to ask for his promise. If the person addressed does not choose to pay that price, all he need do is to reject the offer, but he can bind the offeror only on the terms proposed. Therefore, if the offeror asks for an act in return for his promise, that is, if he asks for immediate payment, or for work, or for the giving of property in return for his promise, no contract can be made if the person addressed says, "All right, I will do it." That is not giving the price the offeror asks for. On the other

hand, should the offeror ask for a promise and not for an act, the acceptor must give the promise asked for by the offeror.

Offer Distinguished from Preliminary Negotiations and Advertisements—It is sometimes difficult to distinguish an offer from other forms of statements. Take the case of a bond list issued by a banking house, or the case of a business house which advertises that it will sell goods for a certain price. The bond list states that the house will sell certain kinds of bonds at the prices quoted. On receiving one of the lists, A decides to buy some bonds, so he goes into the banking house and says, "I will take five of these bonds at the price named here." The banking house says, "We are sorry, but we have no more of those bonds," or it says, "The market has changed and we cannot sell you those bonds at the price listed." Has A a cause of action against the banking house? He has if the bond list amounted to an offer, for by promising to take the bonds he would have accepted the offer and thus completed a contract. But such a bond list would not ordinarily amount to an offer, even though the list expressly stated that the banking house was "offering" the bonds at the prices quoted.

It is not necessary that technical language be used in order to constitute an offer, but the language used must show that some performance is positively promised in return for the thing requested. It must show that the promise is to take effect upon the performance of the thing which is requested in exchange for the promise.

An advertisement generally means only that the advertiser has for sale the goods specified and is willing to part with them at the price named. He invites customers to come in and deal with him on the basis set forth in his advertisement, but he does not promise to assume an obligation to furnish the goods to any customer who pays or agrees to pay the price named. The advertisement is an invitation to come and make a trade rather than a direct offer of a trade. It is possible, however, to word an advertisement in such a way that it amounts to an offer on the part of the advertiser. For example, if a department store should advertise that it had one hundred rugs which it would sell for $10 apiece to the first one hundred customers who asked for them on Monday morning, no customer to get more than one rug, there would be little doubt but that this was an offer. To distinguish between offers and such preliminary negotiations as advertisements, one should consider the definiteness of the language used, its appropriateness to express an undertaking to assume a definite obligation upon the performance of the thing requested, and to the customs of the business.

Oral Agreement Preliminary to Written Contract—Another situation arises quite frequently. Parties talk over a business arrangement and then say, "As this is an important matter, let us put it down in writing; let us have a written contract containing what has been agreed upon." When it comes to drawing up the contract, however, they cannot agree. One party says, "We made a definite oral agreement; let us carry

that out." The other replies, "Why, no, all that was dependent on our making a written agreement." Was there a contract formed by their preliminary agreement or was the contract to come into existence only when this agreement was reduced to writing? It is possible to make such a preliminary agreement binding, although the parties do agree and do contemplate that it shall subsequently be reduced to a formal writing. If all the substantial terms are agreed upon and the only thing remaining to be done is to incorporate the agreement into a formal writing, a contract is formed at this earlier date. The purpose of the writing is merely to furnish evidence of the content of the earlier agreement. However, as a general rule the preliminary agreement is merely a chaffering to fix the terms of the writing, everything is tentative until the writing is made and signed, and no contract comes into being until the formal writing has been executed.

Auction Sale—The auction sale is a good example of what constitutes a preliminary invitation. The auctioneer puts up goods for sale; a bid is made. Perhaps the auctioneer gets no other bid, so he says, "I will withdraw this article from sale." Is the auctioneer liable? Has he made a contract to sell that article to the highest bidder? Does he say, in effect, "I offer to sell these goods to the highest bidder"? If this is the correct interpretation, then when the highest bidder says, in effect, "I agree to buy them," there is a contract. On the other hand, if the auctioneer, like the advertiser, says, in effect, "Here are some goods for sale. What do

you bid, gentlemen?" then the auctioneer is not making an offer. He is inviting offers from the people before him. Until he accepts the offer of one of the bidders, there is no contract and he can withdraw the goods from sale. The latter alternative represents the construction put upon the auction sale, namely, that the auctioneer is not making an offer but is simply inviting offers. Even if the auctioneer promises that he will accept the highest offer, that is, that he will sell to the highest bidder, his promise to accept the highest bid, not being paid for, will not be binding upon him. However, a statute common to many states makes the auctioneer bound to keep his promise to sell to the highest bidder when he makes such a promise or announces that the auction is to be without reserve.

Bids or Tenders—Somewhat similar to the auction sale is the case of tenders or bids for the construction of buildings, or for the sale of goods to a city or to a corporation. Here, too, the corporation or the city is simply inviting offers. It does not say, "We offer to enter into a contract with any one who makes the lowest bid," but rather, "We are thinking of entering into a contract, and we want to receive offers in regard to it." When the offers are made by the bids or tenders, any or none of them may be accepted, as the receiver thinks best. The law sometimes requires that public corporations, such as cities or counties, shall accept the bid of the lowest responsible bidder, but where no statute to this effect exists any or none of the bids may be accepted.

Communication of Offer—Since a contract is formed by the offeree's assent to the offer, the offer must be communicated to him to enable him to give the necessary assent. The necessity for communication is shown in the case of a reward. If you apprehend and surrender an escaped criminal without knowing that an offer of a reward has been made for his apprehension, are you entitled to the reward? In a few states you would be allowed to claim the reward, but in the majority of states you would not be permitted to do so on the ground that your performing the act requested was not an acceptance of the offer since you did not know of its existence.

Implied Offer—An offer and an acceptance are ordinarily made by words, either spoken or written, but any method of communication which would convey a clear meaning to a reasonable man will serve as well as words. If A goes to his grocer and says, "Send me a barrel of flour," he has made no promise in actual terms to pay for the flour, but the natural assumption is that he agrees to pay. The same result might follow if no words of any description were used. Suppose that A goes into a shop where he is known, picks an article from the counter, holds it up so that the proprietor can see what he is taking, and goes out. This act is, in legal effect, a promise by A to pay for the article.

Revocation of Offer—It is a fundamental principle that an offer is not binding until it has been accepted. Therefore, it may be revoked at any time before

acceptance. Suppose that the owner of a mine says, "I will sell you this mine for $50,000, and you may have thirty days in which to decide whether or not you choose to accept this offer." Such a statement, commonly called an option, is merely an offer, whether made orally or in writing, and is not binding as the matter stands. If on the next day the owner should say, "Although I promised to keep that offer open for thirty days, I am going to break my promise and withdraw the offer," he can do so with impunity. After the notice of revocation has been given, no acceptance can be made by the offeree. On the other hand if, before the offer is withdrawn and within the thirty-day limit, the offeree tenders to the owner $50,000 and demands the mine, the offeror is bound and will have to perform his part of the contract.

Irrevocable Option—Under what circumstances could the offer mentioned in the preceding paragraph become irrevocable? If it had been written, with seal attached, and delivered to the offeree, the option would be considered a binding promise under the laws of some states; hence the offer would be irrevocable. Even if the offeror should say to the offeree, "I withdraw that offer," the offeree could disregard the revocation and could compel performance by tendering the $50,000 at any time within thirty days. Suppose the offeree pays the owner $1,000 for the offer to sell the mine for $50,000 at any time within thirty days. In this case the offer, or option, has been paid for. It has become more than an offer; it has become a binding contract that is irrevocable, and the owner is now bound to keep his prom-

ise. It is not an absolute promise to give the mine to the buyer; it is a conditional promise, that is, a promise to sell the mine to him for $50,000 if he chooses to pay that sum for it within thirty days. A conditional promise may be paid for and thus become binding the same as an absolute promise.

Guaranty—A common type of offer is found in the guaranty. A promises in writing that if a certain business house will sell B a bill of goods, he, A, will guarantee the payment of the purchase price—that is, A will pay if B does not. This statement is an offer to a unilateral contract. Until the business house accepts the offer by selling B the goods, A may withdraw it at any time. Suppose A promises in writing that if the business house will sell B whatever goods he may request, A will guarantee payment up to $1,000 worth of goods. B may buy this quantity of goods in different lots and at different times. If he does so, the business house makes a contract with A each time it sells goods to B, up to $1,000 worth, and A's offer is really an offer to a series of unilateral contracts. He may withdraw it at any time before a particular lot of goods is sold to B, but a contract or a number of contracts may have been made by sales of goods to B before the offer is withdrawn. Thus, if the business house had sold goods to B up to $400 worth before A had withdrawn the guaranty, A would be liable on his guaranty up to $400, but the business house could not hold him on his guaranty if it sold B another $100 worth of goods after A had withdrawn his guaranty.

When Revocation Takes Effect—Like an offer, a revocation must be communicated to become effective. X sends an offer to Y by mail today and an hour afterward telegraphs him that the offer is withdrawn. The telegram goes astray and never reaches Y; hence Y does not know that X has changed his mind. Y's acceptance of the offer makes a binding contract. The situation set forth in the following illustration often arises. A sends to B an offer which is to remain open until four o'clock on Tuesday. On Monday morning A mails a revocation which does not reach B until Tuesday morning. On Monday afternoon B mails an acceptance. A contract is formed, for the revocation was not communicated to B before he gave his acceptance. It makes no difference whether B's letter of acceptance reaches A before A's revocation reaches B or afterward.

Revocation of Offer to Form a Unilateral Contract after Part Performance—A troublesome question in regard to the revocation of an offer to a unilateral contract arises where the contract has been partly performed. Suppose that A offers B $5 if B will mow A's lawn. B begins work and has half finished the lawn when A says that he withdraws his offer and refuses to pay B anything. The difficulty here lies in the fact that only by mowing the whole lawn can B make an acceptance of the offer, and before acceptance an offer is not binding. B could stop work after partly finishing the task without incurring any liability since he did not promise to mow the lawn. But is B to get nothing for his work simply because A changes his

mind? This question is a very doubtful one, for it is difficult to find that any contract has been formed. It might be possible on principles of law, apart from the law of contracts, to let B recover the reasonable value of the work which A has had the benefit of, but in many instances it would be impossible to find that part performance had been of any benefit to A. There is a growing disposition on the part of courts, on one theory or another, none of which are very satisfactory, to hold A's promise binding after B has begun performance. So far as part performance is concerned, therefore, bilateral contracts are more desirable than unilateral contracts, because in bilateral contracts the mutual promises bind the parties, and both parties are therefore protected while they are performing.

Termination of Offer by Rejection—An offer may also be terminated by rejection. For example, A may offer B one hundred shares of stock at a certain price and give him a week to think it over. B may say immediately, "I do not care for your offer, I reject it," and then come around the next day and say, "On reflection I have concluded to accept your offer." The acceptance is within the time limit set for reflection, but the offer, on the other hand, has already been terminated by the rejection.

Rejection by Counter Offer—Still another way in which an offer may be terminated is by a counter offer on the part of the person to whom the offer is made. A says to B, "I will sell you stock for $100 a

share, and you may have a week to think it over." B replies, "I will give you $99 a share." A says, "No, I will not take it." Then B says, "Well, I will give you $100." B is too late; he rejected the offer of sale at $100 by saying he would give $99. Of course, if A had said he would accept B's offer to buy when B made the counter offer of $99, there would have been a contract. It happens frequently that an offer is rejected by a counter offer on the part of one who really intends to enter into a contract. Suppose A says, "I will lease you my house for $800 a year." You reply, "All right, I will take it if you will paper the dining room." This conditional acceptance rejects the offer and really amounts to a new offer on your part since you agree to take the house at $800 if the dining room is papered. Only acceptance of the terms of the offer as made will constitute a legal acceptance.

Termination of Offer by Death or Insanity—An offer is terminated by the death or insanity of either party before acceptance. It is not necessary that the fact of the death or insanity of the offeror be communicated to the offeree; its occurrence at any time before acceptance terminates the offer. However, neither death nor insanity after the acceptance has been given terminates the liability on the contract unless the contract is of such a personal nature that only performance by the contractor in person would fulfil it.

Termination of Offer by Lapse of Time—An offer may be terminated by delay on the part of the of-

feree in accepting it. An acceptance of an offer must be made in time, whether the mail or telegraph is used, or whether the parties are dealing face to face. An offer lapses if it is not accepted within the time specified in the offer, provided any time is specified. If no time is specified, then it lapses within a reasonable length of time. The offeror may specify any length of time in his offer, and the offer will remain open during that time provided it is not rejected, revoked, nor terminated by the death or insanity of either party in the meantime.

Frequently an offer contains no express limit of time. Then it is a question of what constitutes a reasonable length of time, and reasonableness depends upon business customs, the character of the transaction, the way the offer is communicated, and similar circumstances. A reasonable length of time for the acceptance of an offer made on the floor of the stock exchange is immediately. An offer sent by telegraph will not remain open long. The use of the telegraph indicates that the offeror considers haste a necessity, and it usually calls for an acceptance in the same manner. An offer sent by mail will remain open longer than one sent by telegraph. An offer relating to things which change rapidly in value will not remain open for as long a time as an offer which relates to land or to something that does not change rapidly in value.

Acceptance—We have considered the various problems involved in the offer; the acceptance is equally important. Without acceptance there can be no mutual assent and hence no contract. The moment when accep-

tance is completed is the time when the contract is made. But when is acceptance complete? How must acceptance be made? What results follow upon an acceptance that is made in some way other than the proper one?

Contracts by Correspondence—Simple contracts are often made by correspondence. An important question arises as to when such a contract is formed. Suppose that a letter containing an offer is sent by A in Boston to B in New York and that the letter arrives in New York on Tuesday morning. On Tuesday afternoon B mails an acceptance which reaches A on Wednesday afternoon. Meanwhile A has mailed a letter of revocation which reaches B on Wednesday morning. We have learned that a revocation is effective only on receipt. If the acceptance follows the same principle, no contract would have been formed in the case in question because the letter of revocation reached B before the letter of acceptance reached A. However, early in the development of the law of contracts it was established that an acceptance takes effect when it is sent, that is, when the letter is dropped into the mail box if that is the method of communicating the acceptance. Therefore A's revocation was ineffective and a contract was formed by B's mailing his acceptance.

Somewhat strange results follow from the principle that an acceptance takes effect when it is sent. If B's letter of acceptance had gone astray, a contract would still have been formed. In sending his offer by mail, A authorized B to use the mail in reply; consequently the

letter of acceptance took effect when it was placed in the mail. Of course this might be a hardship on A, for not knowing that an acceptance had been mailed, he might have acted on the assumption that his revocation had reached B in time. Another result of this principle is that the contract is made in the place where the acceptance is given. Hence in the case supposed, there could be no question as to whether the law of Massachusetts or the law of New York governed the contract since the acceptance of the contract was made in New York.

Condition in Offer Requiring Receipt of Acceptance—Since an offeror may insert in his offer any condition he sees fit, he may stipulate that the acceptance must actually reach him and not merely be dispatched. Furthermore, the condition may specify the time within which the acceptance must arrive in order to be effectual. If the offeror makes such a condition, the rule that acceptance takes effect on sending will not hold, and no contract will be made until the acceptance reaches the offeror, or unless it reaches him within the time specified. To avoid the unfortunate results which may arise from an application of the general rule, it is a wise precaution in business offers to insert in the offer a condition of this nature. One must be careful, however, to be exact in expressing such a condition. It will not be sufficient to add to the offer such words as "subject to prompt acceptance," for prompt acceptance would be given, within the meaning of the law, by dispatching the acceptance, not by the receipt of it. The

condition should be expressed in such words as "subject to prompt receipt of your acceptance," or "subject to receipt of your acceptance" by a stated day or hour.

Means of Communicating an Acceptance—There are numerous problems involved in the question of how an acceptance must be communicated. In order for an acceptance to take effect when sent, it must be sent by what the law calls an authorized means. Suppose that an offer is made by word of mouth and that it is accepted by sending a letter. Does the contract become binding when the letter is sent, irrespective of the receipt of the letter? It does not unless the offeror has in some way authorized the use of the mail in sending the acceptance. If the circumstances are such that the use of the mail is customary, the custom would amount to an implied authorization. This rule would hold true if the offeree lived at some distance from the offeror, in which case it would naturally be expected that, if he decided to accept the offer, he would write the offeror of his decision rather than make a special trip to inform him of it by word of mouth. If an offer is sent by telegraph, an acceptance should be sent by telegraph, and an acceptance started on its way will become binding although it is never received. Similarly, one may authorize a telegraphic answer to a letter containing an offer sent by mail; if the use of the telegraph is authorized, a contract will arise at the moment that the telegram is sent provided there is no condition interposed to the contrary.

Illustrations—If the acceptance to an offer by mail is made by mail and lost in the mail, a binding contract will nevertheless be formed if the use of the mail is expressly or impliedly authorized. Similarly, if the offer calls for payment, there is an implied authority to the offeree to send a check or draft by mail if the parties have been dealing by mail. When parties are in the habit of dealing by mail and an offer calls for the sending of a check, the check becomes the property of the person to whom it is sent as soon as it is mailed. Therefore, when a letter containing a check is lost in the mail, the loss of the check falls not on the sender but on the intended recipient. A lost draft or check, however, can be and must be replaced. Authority to send actual cash by mail is not so easily implied, especially if the amount is large, because it is contrary to good business custom to make cash payments by mail. However, if such authority were given, the result would be the same as in the case of a check, although as a matter of business precaution a letter containing cash should always be registered.

If the offeror, not having received the letter of acceptance and thinking that none has been sent, sells the property which he offered to another person, he is inviting trouble although he is not morally blamable. The seller, or offeror, is liable in damages for breach of the contract which was completed by the mailing of the lost letter. Suppose an option is given by telephone to one who, just before the option expires, tries to get a connection by telephone so as to accept but is unable to do so, although ten minutes after the time has expired

a connection is secured. There is no contract and he has no cause of action. It was through no fault of the offeror that the offeree was unable to accept in time. Generally speaking, one who wishes to accept an offer by means of the telephone must keep the means of acceptance open or take the consequences of failure to do so.

Why does not the same principle apply in regard to the telephone as to the mail and the telegraph? That is, why does not starting the acceptance by telephone complete the contract? It does not because there is no authority to send a communication by telephone to the offeror when the offeree has no telephone connection. When one sends an offer by mail, he is bound by an acceptance sent by mail because he, in effect, asks that an acceptance properly addressed to him be started on its course.

Acceptance by an Unauthorized Means—If the acceptance is by an unauthorized means, it is not necessarily ineffective. Suppose that an offer is made by mail under such circumstances that a reply by telegram is unauthorized. If the offeree nevertheless telegraphs an acceptance, the acceptance is effective provided it reaches the offeror within the same period of time that an acceptance sent in the authorized way would reach him. If it is lost or delayed beyond the time when an authorized acceptance would reach the offeror, no contract is made, while if the telegram is an authorized means of acceptance, its loss or delay does not prevent its effectiveness to complete the contract provided that

it is properly sent. It is important, therefore, to use an authorized means in sending an acceptance. The manner in which the offeror communicates his offer authorizes the use of the same means to communicate the acceptance unless the offeror has specified that a different means shall be used.

Place to Which Acceptance Must Be Sent—Generally an acceptance, to be authorized, must be sent to the place of business of the offeror if he has one, otherwise to his residence. However, an offeror may specify a certain place to which the acceptance is to be addressed. Suppose that an offeror writes at the end of his offer, "Please mail your acceptance to me at my summer residence, Ocean House, Atlantic City." This is the authorized place to which the acceptance must be sent. If the offeree should disregard the instruction and send his acceptance to the offeror's business address, the acceptance would be unauthorized and could become effective only if it reached the offeror within the time that an authorized acceptance would reach him. Of course the offeror may make the means of acceptance or the place to which it is to be sent a condition of his offer. In such a case an acceptance made in any other way would have no effect legally. Suppose that the offeror should say, "You must accept this, if at all, by telephoning me before ten o'clock tomorrow at the Hotel Biltmore." If the offeree should send a telegram to the offeror at the Hotel Biltmore or should send a letter to his office, no contract would be formed even though the acceptance should reach him before the time

specified. Following the exact method prescribed was one of the conditions of the offer which had to be complied with in order to make a contract.

Acceptance Must Comply with the Offer—The acceptance must comply exactly with the terms of the offer in order to be effective. If C offers to give D $5 provided D will carry his bag to town, D cannot accept the offer by promising to carry the bag to town, for C requested an act and not a promise as an acceptance of his offer. If A mails B an offer, and B mails an acceptance, adding the statement, "Prompt acknowledgment of the receipt of this letter is required," no contract will be formed. B has added to his acceptance a qualification which was not contained in the offer, and his purported acceptance is really a counter offer. If, however, B adds, "This letter of acceptance is to be effective on mailing," his acceptance will be good because his added qualification is simply expressing a term implied in the original offer.

Acceptance Must Be Made by the Offeree—The fact that an offer asks either for a promise to be given or for an act to be performed by the person to whom it is addressed makes it clear that a promise given or an act performed by some other person would not constitute the requested acceptance and therefore would not make a contract. In other words, the acceptance must be given by the offeree or by an agent of the offeree. If, for example, an offeree dies before acceptance and his executor, while the offer is still open, purports to

accept the offer, no contract will be made. The executor is not the deceased's agent. If A offers to pay B a certain price for delivering goods to him, and C, without the knowledge of A, supplies the goods, there is no contract on A's part to pay for the goods. If, however, A knew that C and not B was supplying the goods, he would be bound, for C's proffering the goods would be a counter offer which A would accept by taking the goods with such knowledge.

Mistakes in the Use of Language in Offer and Acceptance—Another question which has to do with the express mutual assent of the parties relates to the meaning of the language used. Suppose an offeror says, "I will sell you a cargo of goods from the ship 'Peerless,' due to arrive from India," at a certain price. The buyer assents. There are two ships named Peerless. The buyer thinks one is meant, while the seller has the other in mind. Is there a contract for the sale of the cargo of Peerless No. 1? or a contract for the sale of the cargo of Peerless No. 2? or no contract at all? The rule generally followed is that the language used bears the meaning which a reasonable person in the position of one to whom an offer is made is justified in attaching to it. If a reasonable person in the position of the offeree would think that Peerless No. 1 was meant, then there would be a contract for the cargo of No. 1. If he would not be justified in thinking that but ought to have thought No. 2 was meant, although in fact he did not think so, there would be a contract for the cargo of Peerless No. 2. If one meaning is as reasonable as

the other, then each party has a right to insist on his own meaning, and there would be no contract.

The question of language often comes up in contracts made by telegraph where the words of the telegram are changed by a mistake of the telegraph company. Take the case where a telegram purports to be an offer to sell a large quantity of laths at one dollar a bundle. The terms as actually dispatched by the seller in making his offer fixed the price at one dollar and twenty cents, but the telegraph company dropped off the words "and twenty cents." A telegram is sent back by the buyer, "I accept your telegraphic offer." The offeror is bound by the terms of the telegram. He selected the telegraph as the means of communication, and he must take the consequences of a misunderstanding which arose through a mistake of the agency he himself selected.

Is there any right of action against the telegraph company by the offeror, the sender of the telegram? There is; the company has broken the contract it impliedly made with the sender to use reasonable diligence in dispatching and delivering the message. The difficulty in bringing such an action, however, is that the telegraph company usually protects itself by having printed on the reverse side of the telegraph blank the following, in substance: "On unrepeated telegrams this company is liable for mistakes only to an amount not exceeding twice the cost of the telegram." The sender of the telegram agrees to the contract on the reverse side of the telegraph blank, and he ought to take the precaution of having his message repeated if he desires to hold the company liable in full damages for failure of his mes-

sage to reach the party addressed in the correct form.

When Silence Gives Consent—Still another way of manifesting mutual assent, of which something should be said, is silence. There is a proverb that silence gives consent. Is this so in law? Suppose a man goes to an insurance broker, tosses some policies on his desk, and says, "Renew these policies, please." Nothing else is said, but the man leaves the policies there and goes out. The next night his buildings burn down. Are they insured? They are insured if the insurance broker has contracted to renew the policies; otherwise the buildings are not insured. On the bare facts, as we have stated them, the buildings are not insured; some other facts must always exist to make silence amount to assent. For instance, if on previous occasions the broker had kept silent when such statements were made to him but nevertheless had carried out the proposal, it is fair to infer that this time he meant by his silence what he had meant on former occasions. Of course, when the offer is unknown, silence can never amount to assent. In the case as we have put it, there is nothing to show that the insurance broker even heard the offer; if he did, then the question would depend on whether he had ever done anything to justify the other person's believing that silence would mean assent in such a dealing, or whether business customs justified such an assumption.

The offeror cannot by his own act make the silence of the other person amount to an acceptance. Suppose that A makes this offer to B: "I offer to sell you 100

shares of stock at $50 a share, and unless I hear from you to the contrary by next Wednesday I shall conclude that you have accepted my offer." A does not receive any word before next Wednesday; nevertheless, there is no contract. The person addressed has a right to say, "Confound his impudence, I don't accept his offer, but I am not going to waste a postage stamp on him. He has no business to suppose that if he doesn't hear from me to the contrary I assent." However, if the person addressed wanted to accept the offer and so made no reply with the intention of buying the stock, a contract would have been formed.

When an offeror says that the offeree may accept his offer by remaining silent, there is a contract if the offeree does just that with the intention of accepting the offer. The following is a typical case involving a problem of this kind. A magazine is sent through the mail on subscription for a year, the subscription expires, but the magazine continues to be sent. Is the person who receives it bound to pay another year's subscription? Here you have a little more than silence; you have the subscriber to the magazine continuing to receive it. If he refused to receive it, undoubtedly there would be no contract, but when a man takes property which is offered to him, he is bound by the proposal which is made to him in regard to the property. He ought to refuse the magazine if he doesn't want to pay for it. It may be argued that the receiver does not know that the subscription has run out and that if he did, he would not accept the magazine. But then he ought to know; he made the subscription originally.

CHAPTER II
Contracts—Consideration

THE second requisite in the formation of a simple contract is consideration, the price paid for a promise in order to make it binding. If the price paid is another promise, the contract is bilateral; if the price paid is some act performed or a forbearance, the contract is unilateral.

Legal Detriment—In the law of contracts it is most difficult to grasp the significance of the expression "legal detriment." Briefly, legal detriment means doing what one is under no legal obligation to do. Thus, if A mows B's lawn, his act involves legal detriment since he is under no legal duty to mow B's lawn. Similarly, if a student passes an examination, that act involves legal detriment although it may be an actual benefit to him. On the other hand, if a man pays his taxes, that act involves no legal detriment because he is already under a legal obligation to pay them.

Legal Benefit—Another expression that is difficult to understand is legal benefit. Stated concisely, it is the acquisition of a thing to which one is not legally entitled. Thus, if A gives B a book, he has conferred upon B a legal benefit, inasmuch as B had no legal right to the book before it was given to him. But if A had stolen the book from B and then returned it, he would have given B something to which B already had a legal

right; hence B would have acquired no legal benefit, even though it might have been an actual benefit to have his stolen property returned to him.

Consideration in Unilateral Contracts—A unilateral contract, to be supported by valid consideration, must involve the performance of an act which is a detriment to the offeree. In other words, the act which constitutes the acceptance of an offer to form a unilateral contract must be one which the offeree is under no prior legal obligation to perform. If B offers A $5 to mow his lawn, and A mows his lawn, that act involves legal detriment, as we have already seen. It also constitutes the acceptance of B's offer; consequently the contract thus formed is valid in all respects. However, if B offers A $100 to refrain from trespassing on B's land, A cannot collect the money even though he does refrain. Since A is already under a legal duty to keep off B's land, he does nothing more than he is already legally bound to do. A's act involves no detriment to him as offeree and no benefit to B as offeror; hence it cannot constitute consideration to support a contract.

Partial Payment to Discharge a Debt—The application of this principle of consideration is common in business transactions daily. Suppose that X owes Y a debt of $100 and that Y has been unsuccessful in his attempts to secure payment from X. Finally Y says to X, "If you will pay me $50 of that debt, I will not collect the rest from you." X gives Y the $50. Can Y collect the rest? Except in a few states which have

qualified the common law doctrine, Y can collect the remainder of the debt, and it makes no difference whether Y has given X a written receipt saying that he accepts the $50 in full discharge of his claim. X is already under a legal duty to pay Y $100, and in giving Y $50 or any sum less than $100, X does only what he is already legally bound to do. His act involves no detriment to him, and Y receives no legal benefit, so Y's promise is unsupported by consideration. Even if X sends Y a check for $50 and marks it as being payment in full, the result will be the same. It may be argued that X is under a legal duty to pay Y $50 in money and not by check, and that X therefore does something which he is under no legal duty to do. But a $50 check is no better than $50 in money, and since $50 in money is not legally a sufficient price for Y's promise, the law will not regard $50 by check as any more sufficient.

Suppose that Y says to X, "If you will pay me $50 of that debt and give me your dog, Prince, I will consider the entire debt settled." If X does as Y requests, Y's promise will be binding. In this case X gives Y the dog, a thing which he is under no legal obligation to do; hence X's act involves detriment to him and constitutes consideration for Y's promise. Also, if Y writes out his promise, attaches a seal to it, and delivers it to X in exchange for the $50, Y can collect no more in certain jurisdictions. As we have already seen, where legislation has left the common law doctrine unimpaired, the seal of itself makes the promise binding and does away with the necessity of inquiring whether the

promise is supported by consideration. Some states by legislation provide that a written receipt in full gives the same effect that the common law gave to a sealed instrument. In those states, therefore, if the debtor gets a receipt in full on making a part payment of his debt, he cannot be sued for the balance.

Liquidated and Unliquidated Claims Distinguished—A liquidated claim is one of an exact amount, definitely fixed. Such a claim, as we have seen, cannot be satisfied by partial payment or by a promise of partial payment. However, an unliquidated or disputed claim—a claim subject to a real bona fide dispute, not merely a dispute trumped up for the purpose of questioning a good claim—may be discharged by any payment on which the parties agree. The law does not know how much the unliquidated claim is worth and will therefore allow the parties to bargain for the sale of the unliquidated claim, just as it will let them bargain for the sale of a horse or other property. They may fix such an amount as they choose, and that amount will not be revised by the court. Suppose that A owes B some money for services, the price of which was never exactly fixed, but which B claims are worth $100. If B finally agrees to accept $50 in satisfaction of his claim against A, the transaction is effectual and B cannot recover the rest of his claim.

Part Payment of a Debt by One Who Is Not the Debtor—Consider a somewhat different case. A owes B $100 for a liquidated claim. A's father says to B,

"If you will let my son off, that is, discharge him from this claim, I will pay you $60, not a cent more." B agrees and the $60 is paid. B can never collect any more; the bargain is binding. Although A was bound to pay the whole $100 and could not, by paying B a part of the claim, give good consideration to B for his promise to cancel the balance, A's father was not bound to pay a cent. His act, therefore, involved detriment to him and constituted good consideration for B's promise.

Performance or Promise of Performance of a Legal Duty Is Not Sufficient Consideration—Suppose A has promised to build a house for B for $10,000, but after partially completing the work A finds that, due to increased labor costs, his contract is no longer profitable to him. When he threatens to quit work, B says, "If you will finish the work in accordance with your promise, I will give you $2,000 more." A then finishes his work and demands $2,000 extra. May he collect it? Except in a few states, it is held that A has no claim to the $2,000. He did only what he was bound to do under the terms of his contract, and since his act involved no legal detriment, there was no consideration to support B's promise to pay $2,000 additional. But suppose that B had said, "If you will finish the work and add a bay window to the front room, I will give you $2,000 more." B would then be bound, for by building the bay window A would have done something more than he was legally bound to do under his contract.

Adequacy of Consideration—In considering the illustration just given, it may well be asked if it would make any difference whether building the bay window was worth more or less than $2,000. The answer is that it would make no difference whatsoever. The law does not inquire into the adequacy of the price paid provided the act constitutes legal detriment. It makes no difference whether A promises to give B $100 or $5 for a certain book. In either case there is consideration, but the adequacy of the consideration is not open to question.

Parties may make such bargains as they wish so far as the price is concerned, but there is a limit beyond which a difficulty presents itself. Suppose, for example, A offers to pay B $100 if B gives A his old felt hat. There is no doubt but that the giving of the hat is detriment, but for an act to be consideration for a promise, not only must it involve detriment, but it must be the intention of the parties to consummate a bargain. In a case where the consideration is so obviously inadequate, it is clear that no bargain is contemplated, but that the parties to the transaction are merely arranging for the gift of $100 and are putting up a little alleged consideration as a blind. Ordinarily, however, any exchange that the parties bargain for in good faith will be sufficient consideration if it involves the necessary detriment.

Exception to Adequacy of Consideration—To the principle that the law does not inquire into the adequacy of the consideration provided the parties *intend*

a bargain, there is one exception. If A promises to pay B $100 in return for the payment by B of any lesser sum of money, B's act cannot be consideration even though B is under no legal obligation to pay any sum of money. For this exceptional rule to apply, the promise must be to pay money at the same time and place as the payment is received in return. However, if on a certain date A should promise B, in return for $98, to pay him $100 a month from that date, such a promise would be binding. Occasionally one finds a document that reads, "In consideration of $1 in hand paid, I promise to pay $100." Such a promise is not binding. But should the language read, "In consideration of the sum of $1 and other valuable consideration in hand paid, I promise to pay $100," the promise would be binding.

Consideration in Bilateral Contracts—Bilateral contracts are somewhat more difficult to analyze than are unilateral contracts. In a bilateral contract a promise is exchanged for a promise, so that actually the price paid for one promise is another promise. But not every promise will be regarded by the law as a sufficient price to make the other promise binding. Consequently our problem is to determine what promises are consideration for each other. There being promises by both parties to the contract, the consideration which makes each one of them enforceable must be examined.

Both Parties Must Be Bound—For the validity of any bilateral contract, it is essential that both par-

ties be bound; otherwise neither is bound. In other words, neither promise is binding unless the other is. To this rule there are only a few exceptions. If A, an infant, promises to give B $100 for his horse, the infant's promise is voidable at his election. B cannot enforce the contract against A if A declines to be bound by his promise, and the law permits him thus to avoid his obligation. But even though A is not bound by his promise, B is bound by his, and A can bring suit against him. The case of a lunatic, whose promise is also voidable at his election, is another exception to the rule that both parties to a bilateral contract must be bound or neither is bound.

The Promised Act Must Involve Detriment—The promise that is consideration for another promise must be to perform an act, the performance of which involves legal detriment. If B promises to pay A $100, that promise is consideration for a counter promise from A, since the act of payment involves legal detriment. If, in exchange for B's promise, A promises to give B a horse, A's promise is consideration for B's promise inasmuch as the giving of the horse involves legal detriment. When analyzing a bilateral contract to determine whether it is supported by consideration, the important question that must be answered is just this: Does the promised act of each promisor involve legal detriment to that promisor? Where an act does not involve legal detriment, a promise to perform that act also does not involve legal detriment and hence cannot be consideration for a counter promise. For ex-

ample, if A owes B $100 and B promises to release A in return for A's promise to give B $50, there is not a valid contract; the act that A promises does not involve detriment, since he is already under a legal obligation to pay the money.

Illusory Promises—It is not uncommon for a person to make a promise which actually does not place him under any obligation. Suppose a business house offers to sell Smith specified goods in such quantities as he may choose, and in return for Smith's promise to buy such quantities of these goods as he may choose, the business house promises to supply him with them. An examination of Smith's promise shows that he has not actually promised to do anything. He may or may not choose to order goods from the business house. If he does order goods, his act will involve legal detriment, but he may also exercise his choice of doing nothing and thus incur no legal detriment. Since his promise is not binding, the promise of the business house also is not binding. If Smith orders goods from the house, it can refuse to send them to him without being liable for breach of contract.

If Smith promises to order such goods as he may need in his business, the case is different. Here Smith has virtually promised that he will not supply his needs elsewhere but that he will supply them from the particular business house making the offer. It is true that Smith could control his needs by going out of business, but this alternative also would lead him to do something which he is not under a legal obligation to do.

Since both the fulfilment of his promise and the alternative in this case involve detriment, Smith's promise is binding and therefore is consideration for the promise of the business house. In the latter case Smith reserved to himself only a limited option, while in the former case he reserved an unlimited option. Where a promisor reserves an unlimited option, his promise is called an illusory promise (really no promise at all) which cannot be consideration for a counter promise.

Illusory promises are also common in contracts of employment. Jones promises to pay Smith $5 a day as long as Jones chooses to employ him, and Smith agrees to accept employment on these terms. In this case Jones has promised to employ Smith only if he, Jones, chooses to do so, and by reserving this unlimited option, his promise cannot be consideration for Smith's promise. If Smith wishes to quit after working for Jones for three days, he may do so without incurring any liability even though he has promised to work for Jones as long as the latter chooses to employ him. Of course, Smith can get $5 a day for every day he works for Jones, but he cannot compel Jones to keep him employed, nor can Jones claim that Smith must keep working for him until Jones decides that he does not want to employ Smith any longer.

Forbearance as Consideration—Another kind of consideration that is worth calling attention to is forbearance. Suppose A has a valid claim against B and says that he is going to sue. To induce A not to sue, or not to sue for the present at least, B promises to pay

him a certain sum. This is a good contract provided B's act does not involve doing merely what he is already legally bound to do, that is, so long as A's claim is not for a liquidated sum of money and B's promise is not merely a promise to pay part of that liquidated sum. A may promise what B requests, either to forbear temporarily or to forbear permanently. Either promise will be good, for A has a legal right to sue immediately and he promises not to exercise that right.

Suppose, however, that A has no valid claim against B, but B is reputed to be a rather easy mark in the community and A, who is a person of little scruple, trumps up a claim against B with the hope of obtaining a compromise. Is forbearance of this false claim by A good consideration for B's promise? It is not. A's claim must be a bona fide one in order to make the forbearance to press it, either temporarily or permanently, good consideration for a promise of payment.

Charitable Subscriptions—The subject of charitable subscriptions presents an anomaly in the law of consideration. For example, a college which wishes to raise money for a new dormitory gets a number of persons to agree to subscribe to the fund. They sign various kinds of subscription blanks, in substance promising to give the college different sums of money. Among the subscribers is A who has promised to give $10,000. After the college has incurred labor costs for the building, A dies without having paid his subscription. His executor has no right to make payments from the estate unless the estate is legally indebted, and so

the question arises as to whether or not A's promise is binding. The college has spent money and done many acts that it was under no legal obligation to do. Other subscribers may have promised to give sums because A had promised to give that substantial sum, and they had no legal obligation to give anything. Both the acts of the college and the acts of the other subscribers involve legal detriment, but in neither case were they bargained for by A in exchange for his promise. He may have known that such results would follow upon his making his promise, but he intended to make a gift to the college and not to bargain for these acts or for others as the price of his promise to make a subscription.

Since the acts that involve legal detriment must be bargained for in order to constitute consideration, A's promise would seem not to be supported by consideration and hence not binding. However, the courts now generally enforce charitable subscriptions, basing consideration for the promise on some such argument as that outlined above. Indeed, in order to give the appearance that there is consideration for the promise when actually there is none, it is a common practice for charitable institutions to insert in their subscription blanks words to the following effect: "In consideration of other similar promises made by other subscribers, I agree to give," or, "In consideration of the charity undertaking the work described, I agree to give." Statements of this kind make it easy for courts to hold the promises binding, although they will generally do so even in the absence of such language.

Past Consideration and Moral Consideration—Past consideration means a price that was given before a promise was made. Thus if A sells his horse to B for $100 and after the sale is made warrants (or promises) that the horse is not more than three years old, the consideration for that promise is the already executed sale. Strictly speaking, such consideration which is past is no consideration at all. B paid nothing for the warranty, his $100 having already been paid for the horse. A's promise is consequently not binding, for it is supported only by past consideration which, as we have said, is no consideration.

Moral consideration is similar to past consideration; it also is no consideration at all. If a friend should give me $100 when I was in need, I might feel morally bound to repay that sum upon regaining a position of affluence. If I should promise to repay it, my promise would not be binding, for its only support would be moral consideration. In few states a "strong moral consideration" is recognized, but generally it is accorded no recognition. To the general rule regarding past consideration and moral consideration, there are a few exceptions which will be discussed later.

Statute of Limitations—All states have statutes of limitations which bar suits upon valid claims after the expiration of a certain period of time. The purpose of such statutes is to force parties to settle their disputes with a certain degree of promptitude. The period of time varies for different kinds of claims. In most states action on a judgment may be begun within twenty years

after the judgment is rendered; so in some states may an action on a contract under seal. Ordinary contractual claims, on the other hand, generally expire in six years, while claims in tort—that is, for injury to person or property—last even a shorter time. The Statute of Limitations begins to run against a promissory note or other contract, not from the time when it is made but from the time when, by its terms, it is to be performed. A note made July first and payable the first of January next will be barred six years from the first of January, not six years from July first. If a note is made payable in ten years, as a mortgage note may well be, the statute will not bar it for sixteen years.

Promise to Pay Barred Debt—One of the exceptions to the rule of moral and past consideration is that a new promise will revive a debt so far as the Statute of Limitations is concerned. The existence of the old indebtedness is regarded as a sufficient consideration, although it can hardly be said that the old debt is the price given for the new promise. A promissory note payable January 2, 1929 would in the natural course of events be barred on January 2, 1935. However, if in 1935 or 1936 the maker should say, in effect, "I know I owe that old note, but I will pay it," he would be liable on his new promise; the statute would begin to run anew and would run for six years from the date the new promise was made. It is not sufficient that the debtor admit there was a liability; he must promise to pay the debt to make himself liable for another six years.

Instead of a new promise made in 1935 or 1936,

after the statute had run, the maker might say prior to the expiration of the statute, in 1934 for example, "Don't worry about that note, I will pay it." In this case his promise would start the statute running afresh from the date of the promise. In other words, a new promise made before the statute has completely run, as well as one made after the statute has completely run, will start the statute running anew and will serve to keep the debt alive for six years from the time the new promise is made. If the new promise is made on the day following maturity of the old obligation, the effect will be simply to extend the time of the statute one day, because only one day of the six years has run at the time the new promise is made. In many states it is now required by statute that the new promise be in writing.

Part Payment of Barred Debts—Not only will a new promise in express terms keep the Statute of Limitations from barring a claim, but a part payment of the debt will have the same effect, unless at the time the part payment is made some qualification is expressly stated. A debtor may say, "I will pay you this much of my debt, but no more," and incur no further liability; but a part payment without some such qualification starts the statute running afresh as to the balance of the debt. Notes are frequently kept alive for a long period of years by means of part payments. Interest payments are as effectual as part payments of the principal for the purpose of keeping the notes alive. A new six years' period begins to run from the date of each payment of interest. However, the debtor may say, "I will pay you

half this debt" or "I will pay you the debt in instalments of $10 a month." Such promises are binding according to their terms and do away with the Statute of Limitations to that extent, but they do not enable the creditor to recover anything more than the debtor promises.

Revival of Debts Discharged by Bankruptcy or Voidable for Infancy—A second exception to the rule of past and moral consideration is the revival of an obligation which has been discharged by bankruptcy proceedings. If a discharged bankrupt promises to pay his indebtedness or makes a payment on account of it, his old obligation will be revived and he will again be liable. The moral obligation of the bankrupt to pay his debts in full is the so-called consideration.

A third exception is found in the case of an infant, that is, a minor under the age of twenty-one. Except for what are called necessaries, that is, food, clothing, shelter, and the like, an obligation of an infant is voidable at his election. After he has gained his majority, however, a promise to pay an indebtedness which he incurred during his minority will be binding.

A fourth exception relates to promissory notes. An indorser of a promissory note is liable only provided the maker does not pay and provided further that he is given notice of this failure to pay, within the time prescribed. If at any time before or after maturity of the note, an indorser "waives demand and notice," that is, if he promises to pay even though the holder has failed to notify him, his promise is binding.

CHAPTER III

The Statute of Frauds

MENTION has been made of a few cases where it is necessary for an enforceable contract to be in writing. A contract under seal, by its very nature, requires a writing. In many states promises to pay debts barred by the Statute of Limitations must be in writing. Most other contracts which must also be in writing are covered by the provisions of what is known as the Statute of Frauds. This statute was passed in England in the year 1676 and is known as Chapter 3 of the Statute of 29, Charles II. It was passed for the purpose of preventing frauds and perjuries which were particularly prevalent at the time of its enactment. As to how much good the statute has accomplished there is some doubt, but unquestionably in many cases it has caused fraud and perjury rather than prevented them. This is freely admitted.

The statute as passed in England has been adopted in practically every state in this country with slight modifications. It is, therefore, a part of contract law to which attention must be given. The contracts covered by the Statute of Frauds may be grouped under the following headings: (1) personal contracts of executors and administrators, (2) guaranties, (3) promises in consideration of marriage, (4) contracts for the sale of land, (5) contracts not to be performed within a year, (6) contracts for the sale of goods. These subdivisions will now be discussed in detail.

Personal Contracts of Executors and Administrators—An executor or administrator is the person who settles the estate of a deceased person. If he is named in the will, he is called an executor, but if the will fails to name an executor or the person dies without making a will, an administrator is appointed by the court. The executor or administrator is not obliged to pay the debts of the deceased person out of his own income if the estate is insufficient. His liability is limited by the assets of the deceased. The Statute of Frauds provides that any promise by an executor or administrator "to answer damages out of his own estate" must be in writing. Thus, if for any reason an executor or administrator chooses to make a promise to bind himself personally for any of the debts of the estate, that promise must be in writing to be binding.

Guaranties—Another section of the statute requires that all guaranties, to be enforceable, must be in writing. Guaranties form a very important class of contracts and should be distinguished from contracts somewhat similar in character. Suppose A writes to Altman & Company as follows: "Please sell B six shirts and charge them to my account." This is not a guaranty. A is just as much a purchaser as if he had ordered the shirts sent to himself. Nor is it made a guaranty if A and B agree that B shall pay A for the shirts. On the other hand, if A writes to Altman & Company, "Let B have six shirts, and if he doesn't pay, I will," there is a guaranty. To constitute a guaranty, it is essential that there shall be a principal debtor

and that the guarantor's liability shall be only secondary. An enforceable guaranty must be in writing.

To put the matter another way, when there are three parties to a transaction, the promise must be in writing to be binding; when there are but two parties, no writing is necessary. When A says to Altman & Company, "Let B have six shirts, and if he doesn't pay, I will," there are three parties: A, the guarantor; B, the principal debtor; and Altman & Company, the creditor. Therefore the guaranty must be in writing. When A says to Altman & Company, "Sell B six shirts and charge them to my account," there are only two parties: A, the principal debtor; and Altman & Company, the creditor. Therefore no writing is necessary. In this connection it should be kept in mind that some oral contracts, which appear at first glance to be good, may not be enforceable under another section of the Statute of Frauds because the amount involved is over a specified sum.

Promises in Consideration of Marriage—The statute provides that "agreements made in consideration of marriage" must be in writing. The agreement referred to by this section is not the contract or promise to marry but the agreement for a marriage settlement, such as a promise to make a payment of money or a settlement of property in consideration of a marriage actually taking place.

Contracts for the Sale of Land—By the provisions of the statute, any contract for the sale of land or for

any interest in or concerning land requires a writing in order to make it binding. Contracts for the sale of land or for an interest therein must be distinguished from conveyances of such interest. The contract is the promise to transfer an interest in land; the conveyance is the instrument by means of which that interest is actually transferred. The provision of the statute under discussion relates only to contracts; there are other provisions of the statute relating to conveyances and leases which will be considered in the chapter on real property. Contracts to sell or exchange land, to give or take a lease, to assign a lease, or to give a mortgage are common examples of contracts which are required by this section to be in writing.

At an early date equity courts viewed this section with hostility, and so it gradually developed that if the purchaser, after the making of an oral contract, went into actual possession of the land with the seller's consent, the courts would enforce the contract. This doctrine still persists, and where the purchaser goes into possession of the land, the court will compel the seller to convey the land, although a court of law would not give the purchaser an action for damages.

Contracts Not to Be Performed within a Year—The statute also requires that an agreement not to be performed within a year must be in writing. This provision of the statute has been the subject of rather an odd construction by the courts. The words "not to be performed within a year" have been construed to mean "which cannot possibly be performed within a year."

Contrast the contract made by A with B to employ B for a year and a day with the contract made by A with B to employ B for B's life. The first of these promises is within the statute and must be in writing; the second, although it seems to be for a much longer period, the whole life of the promisor, is not within the statute. B may die within a year and by his death completely perform his promise; since there is a possibility of performance within a year, the agreement need not be in writing. The contract to hire B for a year and a day cannot possibly be performed within a year. It is true that B may die within a year, but this has no bearing on the question. The agreement of the parties was with respect to service for a year and a day and that contract cannot possibly be completed within a year.

Contracts for the Sale of Goods—A contract for the sale of goods exceeding a certain amount in value must be in writing, unless a part or all of the goods have been delivered or a part or all of the price has been paid. The value of the goods which brings a sale within this section of the Statute of Frauds varies in different states, and local statutes should be consulted to ascertain the law in this connection. Goods are generally held to include stocks, bonds, and other evidences of indebtedness. A contract for work or for labor to be performed is not a sale of goods within the meaning of this provision.

Miscellaneous Cases—In addition to the kinds of contracts, enumerated in the English statute, which

have been adopted generally in this country, there are two or three other classes of contracts which in a number of states are required by statute to be in writing. One is a contract to make a will in favor of a certain person. This is not a very common kind of contract, but occasionally a man promises, in consideration of certain services, to make a will in favor of another. In cases of this kind the possibility of fraud is considerable. The testator is always dead before the question comes up, so that if the alleged promisee were allowed to prove by oral statements that the testator made a contract to bequeath his property on the terms which the promisee says were agreed upon between them, it would have the same effect as making oral wills valid.

In some states a contract of a real estate agent for commissions is required to be in writing. A contract with an agent empowering him to sell real estate, though not regarded at common law as within the section of the statute which requires the sale of an interest in land to be in writing, is in many states by special enactment required to be in writing. A contract for a loan of money reserving a rate of interest higher than that ordinarily allowed by law may be required to be in writing.

What Constitutes Writing—The writing required by the Statute of Frauds to make the promise binding is required only as a matter of proof. It need not necessarily be made at the time the contract is entered into. If the writing is made at any time before an action upon the contract is begun, there is sufficient compliance with the statute. In order to be sufficient, the writing must

be signed by the party to be charged or by his agent. It must also show who the parties to the agreement are, if not by naming them, at least by such a description as will point to specific persons. A letter addressed simply "Sir" and signed by the party to be charged, but not containing the name of the person addressed, is not sufficient. All the terms of the contract must also appear in the writing, such as subject matter, price, terms of credit, or any express warranty. As often happens, all these terms need not be expressed in one writing. Contracts are frequently made as the result of an extended correspondence. In such cases the various letters may be put together and construed as one writing if they obviously refer to one another, and thus all the terms will appear in writing. The statutes in some states require "subscription" of the signature, in which case the signing must be at the end; but where there is not such a requirement, a signing in the body of the instrument is sufficient.

Alteration of Written Contract by Spoken Words—It is worth while to consider the rules of law relating to the alteration of written contracts by parol evidence. The first, or parol evidence rule, may be stated thus: Where parties have executed a written contract purporting to state the terms of their agreement, the court will not receive evidence that, at or before the time when the written agreement was executed, they orally agreed to something less or more or different. The written agreement is taken as conclusive evidence of the contract made at that time. In trying to ascer-

tain what the writing means, however, the court will permit the surrounding circumstances to be shown, and the meaning of technical or trade terms or abbreviations may be proved. It may also be shown that the parties did not intend the written agreement to be effective until the happening of some particular event; but if the writing was executed as an expression of the intention of the parties at that particular time, the only endeavor of the court will be to ascertain the meaning of the written words and to enforce them as written.

The parol evidence rule thus relates only to the oral testimony of the parties prior to or contemporaneous with the written agreement. It does not concern oral agreements made subsequent to the writing. The only rule that affects such agreements revolves about the Statute of Frauds. We must consequently distinguish between (1) contracts of which the law requires written evidence because they are within the Statute of Frauds, and (2) contracts which the law does not require to be in writing, but which, nevertheless, are written. Contracts of the latter sort may be rescinded, added to, or subtracted from by any subsequent agreement which conforms to the requirements of the law governing mutual consent and consideration.

If the Statute of Frauds requires the original contract to be in writing, it cannot be varied by oral agreement, although it may be orally rescinded. To permit such an oral agreement would, in effect, violate the Statute of Frauds since the court would be permitting an agreement partly in writing and partly oral to be enforced.

CHAPTER IV

Parties to Contracts

ORDINARILY any person is presumed to be capable of making a contract, but the law imposes upon certain classes of persons, in varying amounts and for their own protection, disabilities to make contracts which may be enforced against them. It also imposes upon some, for considerations of public policy, disabilities to make enforceable contracts. These persons may be classed as follows: (1) infants, (2) insane persons, (3) drunkards, (4) married women, to a limited extent, (5) artificial persons or corporations.

Capacity to Contract

Infants—All persons under the age of twenty-one are considered infants, except that in some states by statute women attain their majority at eighteen. The law endeavors to protect those who lack experience and sound judgment so that they may not suffer loss of property because of their inability to deal safely with others who might take advantage of them. It may well be that an infant who has nearly attained his majority is as able to protect his interests as a person of legal age, but the rule is one of universal application and no attempt is made to measure the ability in each particular case. For the greatest good of the greatest number, therefore, the law conclusively presumes that all those under twenty-one years of age have not yet gained suffi-

cient ability to cope with others on an equal basis in the preservation of their property.

Contracts of an Infant—The contracts of an infant are voidable; that is, although they bind the other party to the bargain, the infant himself may avoid them. If he avoids a contract, the adult with whom he contracted is entitled to recover as much of what he gave the infant as still remains in the latter's possession. If the infant has spent, or used, or for any reason no longer has the consideration which the adult gave him, the infant may avoid his own obligation, provided he has not already performed it; if he has already performed it, he may reclaim what he has given. After he comes of age, but not before, the infant may ratify his contracts which then become binding upon him. The retention after coming of age of property received by the infant during his minority amounts to a ratification.

There are a few obligations of an infant which, on grounds of public policy, are binding upon him. A contract to perform military service is binding. The marriage of an infant is binding, although he may repudiate his engagement without being liable for breach of contract. It is frequently held that an infant's contract for necessaries is binding. Strictly speaking, this is not true. The infant is liable for necessaries, but his obligation does not depend upon his contract; it is an obligation imposed by law, or what is called a quasi-contract. The importance of this distinction is shown in cases where the price agreed upon exceeds the real value of the necessaries. If the contract were binding, the

infant would be bound to pay the agreed price. In actual fact he is liable only for the fair value of the goods. What is necessary for an infant depends upon his station in life, upon whether he already has a sufficient supply of the necessary article in question, and upon whether he is receiving proper support from a parent or guardian. The privilege of an infant to disaffirm his contracts is generally held to exist even though the party dealing with him not only reasonably believes the infant of age but has received actual representations from the infant to that effect.

Insane Persons—The law affords protection to insane persons for the same reason as in the case of infants, namely, that those who are incapable of understanding what they are doing and of comprehending the effect of their contracts upon their property should be safeguarded against the designs of the more capable. As in the case of infants, protection is afforded to the insane person only; the other party to the contract may not avoid his contract by pleading that it was made with an incompetent person.

Modern science has clearly established the fact that a person may be insane on one subject and yet possess a clear understanding and be perfectly sound on another. If the contract deals with a subject of which the person has a clear understanding, he is not in need of protection and is given none. Protection is given only to those who do not possess the mind to understand in a reasonable manner the nature and effect of the acts in which they engage.

Contracts of an Insane Person—Insane persons must live; consequently they are bound to pay for necessaries furnished them. However, they are bound only for the reasonable value, as in the case of infants. The rules for determining what these necessaries consist of are the same as for infants.

It is often a difficult matter to know when a person is insane, much more difficult than it is to determine a person's age. One of the contracting parties may have acted in good faith, being entirely ignorant of the other's unsoundness of mind and having no judicial determination of insanity or other warning to put him on his guard. The contract may even be reasonable in its terms, and it may have been so acted upon that the parties to it cannot be restored to their original positions. While the law should protect the incompetent, in such a case it would clearly be injustice to protect him to the extent of making the other party suffer through no fault of his own. It has been quite generally determined in this country, therefore, that where a person does not know of the other's insanity and there has been no judicial determination of such insanity to notify the world of it, the contract is binding upon the insane person as well as upon the other party, provided it is a fair one and has been so acted upon that the parties cannot be restored to their original positions.

In some states it is held that all contracts of an insane person are void. In such states, of course, the rule stated above would not hold. Therefore the statutes or decisions of each state must be consulted to determine the law in that particular state. In some states,

an insane person's deed of land has been held to be void, without reference as to whether or not the other party entered into the contract in good faith and without notice, or that the contract had been so far acted upon that the parties could not be restored to their original positions. An insane person's power of attorney has also been declared by some states to be absolutely void.

In most jurisdictions an insane person's contracts are voidable by him or by his guardian, provided (1) that the other person knew of his insanity at the time of making the contract, or (2) that he had been declared insane by some court, or (3) that the parties can be restored to their original positions.

In the case of a voidable contract, when the insane person's reason has been restored, he may, by acts or words, avoid the contract he made during his insanity, or he may in like manner ratify it, or he may ratify it by not avoiding it within a reasonable time after recovering his reason. Ratification in the second case may be accomplished simply by continuing to keep something capable of being returned which was obtained under the contract.

What Constitutes Drunkenness—It is not ordinary drunkenness which excuses a man from his contracts and enables him to claim the protection given generally to incompetent persons. The drunkard must have been so utterly deprived of his reason and understanding that he could not comprehend the nature or effect of the act in which he was engaged. The fact that he was so much under the influence of liquor that

his judgment was not as good as when in his normal state does not excuse him.

Married Women—It is practically impossible to state in brief form the law upon the subject of married women's contracts. The difficulty arises as a result of the diverse changes made in the plain and clear rules of the common law. The old law was wholly incompatible with the enlightened view now held in regard to women, their family, social, and business standing, and changes have been made by statute to give women the rights to which they are justly entitled. However, inasmuch as the statutes in the different states have not been uniform, the law today is rather diversified, and the statutes and decisions in each state must be consulted to determine the law in that state. Because of the complication of the law, business men should obtain legal advice before entering into important business dealings with married women.

The Old Rule—Under the common law a woman's existence upon her marriage became merged in that of her husband, and husband and wife were regarded for many purposes as one person. Whatever tangible personal property she had became his immediately upon marriage, and he had the right to reduce her bills, notes, bonds, and other debts to his possession. The wife retained title to her real property, subject to the right of the husband to have the use of it during his life and after her death if children were born of the marriage. The husband was bound to supply his wife with neces-

saries, and so long as he did this her contracts for things of even ordinary use were void. However, if he failed to supply the necessaries, her contracts for them were valid. Aside from this exception, all contracts of the wife were absolutely void, not simply voidable.

Changes Made by Statute—As previously stated, the law relating to married women's contracts has been greatly changed by legislative enactments to give married women the rights which the more enlightened view of the present time accords to them. The changes made by the various statutes have gradually developed the married woman's capacity to contract. However, there are so many variations in the different states that it is impossible even to summarize them adequately here. Generally speaking, a married woman may now contract except with her husband and except as surety for him. In many states even these two exceptions do not hold.

Corporations—A corporation may contract as freely as an individual so long as its contracts are within the business powers and scope of the business authorized by its charter. Even if a corporation has made a contract outside the scope of its business, and the contract has been so acted upon that either party has had the benefit of the contract, an action will lie in favor of the other for the benefit so conferred. But where a contract outside the scope of the business which its charter permits the corporation to engage in is wholly executory, the courts will not enforce it. Such

contracts are said to be "ultra vires" (beyond one's powers). Contracts entered into with a corporation may be in the same form as contracts between individuals, and a corporation need use its seal only where an ordinary person is required to use a seal. However, the officers making a contract on behalf of a corporation must be authorized so to do either by the directors or by the general powers given such officers.

THIRD PARTY BENEFICIARIES TO CONTRACTS

The Limits of Contractual Relations—As a general rule, a contract does not impose liabilities nor confer rights on a person who is not a party to it. Since a contract is the result of a voluntary agreement entered into by the parties, any contractual rights or liabilities existing by virtue of such voluntary agreement between the parties are no concern of others. For example, C and D cannot be bound by any of the provisions of a contract between A and B, nor can a breach of that contract give them any rights. There are certain exceptions to this rule, one of which arises in connection with agency. An agent represents his principal when entering into a contract for that principal, but a contract made by an agent can bind his principal only by force of previous authority or subsequent ratification; hence the contract which binds the principal is really his own contract.

A second exception arises where the rights and liabilities created by a contract are passed to a person other than the original party to the contract, either by act of

the parties themselves or by operation of law. If A by contract bound himself to pay money to B, and B assigned to C his right to collect the amount, such an assignment by act of the parties would be valid. If Jones contracted to pay Smith $100 and Smith died before the contract was completed, his executor or administrator would be invested with the right to collect the money from Jones; in other words, Smith's right would be assigned to his personal representative by operation of law.

A third exception is commonly spoken of as the third party beneficiary doctrine, which will be discussed in the following paragraphs.

The Rule of Lawrence v. Fox—The principle of the third party beneficiary can best be illustrated by a simple case. Suppose that Jones promises to give Smith a horse in return for Smith's promise to give Green $100. Notice that Smith makes his promise to Jones. Green may not even know of the promise at the time it is made; therefore he is not actually a party to the contract since he is neither promisee nor promisor. He is what is termed a third party beneficiary. If Smith refuses to pay, may Green sue Smith on the latter's contract with Jones? Under the general rule a negative answer would seem to be correct. However, since the adjudication of the leading case of Lawrence v. Fox, 20 New York, 268, the law has generally established the contrary doctrine (Green may sue Smith), but to understand the present state of the law, two different situations must be appreciated, namely, that of

the creditor beneficiary and that of the donee beneficiary.

Creditor Beneficiary—Suppose that Jones owes Green $100 and that, in return for a horse given to Smith by Jones, Smith promises Jones to pay the latter's debt to Green. Notice that before this contract is made Green is already a creditor of Jones. Notice also that Green is not a party to the contract between Smith and Jones but simply a beneficiary. Since Green stands in the relationship of a creditor to Jones, he may be termed the creditor beneficiary to the contract between Jones and Smith. Despite the making of the contract, Green may still sue Jones, for his original claim against Jones has in no way been destroyed by the contract made between Jones and Smith. But may Green, if he chooses, sue Smith? The law governing the third party creditor beneficiary situation will determine.

A situation of this nature commonly arises in the case of a sale of real property with a mortgage attached. Jones mortgages a piece of property to Green for $10,000. Jones later sells the property to Smith who pays Jones $5,000 for it and also assumes the payment of the mortgage as part of the purchase price. The question of whether the mortgagee, Green, can sue the new owner, Smith, depends upon the law concerning third party creditor beneficiaries. Another common situation is found in the sale of a going business. Jones sells his business to Smith who, in part payment of the purchase price, agrees to pay the creditors of Jones. The question of whether one of these creditors can sue Smith

hinges on the law governing third party creditor beneficiaries.

Donee Beneficiary—If in the Jones-Green-Smith situation the relationship between Jones and Green is not that of debtor and creditor, then Green is simply a third party donee beneficiary. In securing Smith's promise to give something to Green, Jones may have intended simply to make a gift to Green indirectly. In such a case, although Green has paid nothing for Smith's promise, Jones has. The life insurance contract is about the most common example of the third party donee beneficiary. Jones takes out insurance on his life and names Green as his beneficiary. Such a policy is a contract on the part of the life insurance company to pay Green, who is simply a donee beneficiary, a certain sum upon the death of Jones.

The Legal Rights of Beneficiaries—There is lack of uniformity in the laws governing the rights of third party beneficiaries in different jurisdictions. In England, for example, the third party beneficiary has no rights whatsoever, whether he be a donee or a creditor beneficiary. The English rule is followed by a few states in this country, but even these states have certain illogical, ameliorating doctrines.

The general American doctrine permits the third party beneficiary to sue, but since there are many variations in the different states, an authoritative answer cannot be given without first examining the law of the particular state in question. Some states will permit

a creditor beneficiary to sue but will deny that right to a donee beneficiary. Other states follow the opposite practice. Then there are more complicated variations. New York, for example, permits a suit by the creditor beneficiary but denies it to the donee beneficiary unless there is some kind of a moral obligation owing to him by the promisee. All states, either by legislation or by judicial decision, grant the beneficiary of a life insurance policy the right to sue the insurance company. Because of the difficulty of ascertaining the rights of a third party beneficiary in any particular jurisdiction, a business man should seek the expert advice of a lawyer, but he should also have sufficient familiarity with the principle to enable him to know when a particular situation involves the problem of the rights of a third party beneficiary to a contract.

ASSIGNMENT OF CONTRACTS

Meaning of Assignment—Much of the difficulty regarding assignments of contracts arises from the different meanings which may be attached to the word assignment. When property is assigned, the assignee becomes the owner in every sense of the word if the person from whom he takes the assignment has a valid title. This is not true of the assignment of a contract. Under the common law, contract rights, or "choses in action" as they are termed in law, were not assignable on the ground that one party who contracted with another party could not, without his consent, become bound to a third party.

Power of Attorney to Collect a Claim—Although a man who had a contract right could not, by common law, make a third party the owner of the claim in a complete sense, he could give to the third party the power to collect the claim as his agent and could authorize the third party to keep the proceeds when the claim had been collected. It long ago became the established law that when an owner of a claim purported to make an assignment of that claim, he thereby gave to the assignee the power to enforce the claim in his stead. Such a power given to the assignee is irrevocable if the assignee has paid for it.

Effect of Assignment of a Right—It may be supposed that the effect of the assignment of a right, where the assignee is treated as an agent or an attorney of the assignor, is the same as if the assignee were fully placed in the position of the assignor as owner of the claim, but this is not quite true. Assuming that the claim is not represented by negotiable paper, the assignor is still the legal owner of the claim; if the debtor pays the assignor in ignorance of the assignment, the debt is discharged, and the assignee has no right of action except against his assignor for the latter's fraudulent conduct in collecting the claim after having assigned it. If, after having made one assignment, the assignor makes a subsequent assignment, the second assignee also has a power of attorney to collect the claim and keep the proceeds. If the second assignee collects the claim in good faith and in ignorance of the prior assignment, he can keep what he has collected;

and since the debtor is not liable to the first assignee, the latter must seek redress from his assignor. It is therefore most important that the assignee of a non-negotiable chose in action give immediate notice to the debtor of the assignment.

Non-Assignable Rights—Rights which are personal in nature cannot be assigned. The person who has contracted to paint a picture cannot delegate that duty to another, no matter how skilful the other may be. One who has a right to the personal services of an employee cannot assign that right to another. A publisher who has a right to publish all the books written by a certain author cannot assign his right to another publisher.

What Amounts to an Assignment—No particular words are necessary to constitute an assignment. Any words which show an intention that another shall be the owner of a right are sufficient to constitute the latter an assignee. An order addressed to a debtor of the drawer directing him to pay the debt to a specified payee is an assignment of the debt when delivered to the payee. This case must be sharply distinguished from a bill of exchange or check. A bill of exchange or check is an order to pay a certain amount unconditionally, irrespective of whether or not any particular fund exists. Only an order to pay from a particular fund, that is, an order which is expressly or impliedly conditional on the existence of that fund, constitutes an assignment.

Gratuitous Assignments—There need be no consideration given by an assignee for an assignment. Under a gratuitous assignment, an assignee has the power to collect a claim, but a gratuitous assignment, like any promise for which no consideration is given, is revocable. A revocation of the assignment operates to divest the assignee of his power to collect the claim, but if he has already collected the money, there can be no revocation. It is evident that if the revocation of an assignment would automatically take from the assignee his power to collect the claim, the debtor would be placed in an awkward situation. He might have been informed of the assignment but not of the revocation. If his payment to the assignee on the strength of the assignment would not discharge him, he would have to pay a second time to the assignor. To prevent such a situation arising, the courts have ruled that revocation of a gratuitous assignment, so far as the debtor is concerned, does not become effective until he has been informed of it. Thus the debtor may safely pay a gratuitous assignee unless he knows or suspects that the assignment has been revoked. In addition to express revocation, the death of the assignor operates as a revocation of the assignment.

Successive Assignments—An assignment given for consideration, like any binding promise, is irrevocable, but an assignor may fraudulently make two or more assignments thereby giving two or more persons authority to collect one claim. What are the rights of these assignees, as among themselves, before and

after collection? The assignee who first collects the claim may keep the money he has collected provided he has no notice of another assignment. Similarly, if the debtor pays either assignee without notice of the other assignment, he is discharged and cannot be made to pay again. In cases where the assignee or the debtor has notice of more than one assignment, the situation is somewhat different. An assignee who has such notice may keep the money he collects only if he had legal claim to it before collection. If the debtor who has such notice pays one of the assignees, he is discharged only if he pays the right assignee, that is, the assignee who was entitled to the claim before collection.

As between two successive assignees, which one is entitled to the claim? There are two different rules. A majority of the states follow the rule that the first assignee is entitled to the claim as against any later assignee. Priority of time is the guiding consideration. However, a number of the states follow the rule that where the second assignee does not know of the first assignment, the assignee who first gives the debtor notice of his assignment takes precedence over the other. Because of this rule and because, under the other rule, a debtor without notice of a prior assignment is discharged by paying the claim to a second assignee, it is essential that an assignee notify the debtor immediately of the assignment in order that he may thereby protect himself.

Liability of the Assignor—When an assignment is made, an assignor may make any guaranties he chooses

as to the collectability of the claim, and these guaranties may be enforced. Ordinarily, however, an assignment is made without any express guaranties, and the problem thus arises as to what implied guaranties accompany a simple assignment. The assignor impliedly warrants that he will do nothing to defeat the claim; hence if he collects it himself, or makes a second assignment and the second assignee collects the claim, the original assignee can sue the assignor for such damages as may have been incurred. The assignor also warrants that there are no defects in the claim other than those of which he informs the assignee. Thus, if he has made a prior assignment or the claim does not exist, the assignee can hold the assignor. However, the assignor does not impliedly guarantee that the assignee will be able to collect the claim. If the debtor becomes insolvent, for example, the assignee has no right of action against the assignor.

Extent of Assignee's Right—The assignee receives no greater right than the assignor had. Any defenses which the debtor had as against the assignor at the time of the assignment, or which were acquired before notice of the assignment, are good against the assignee. This rule is based on the principle that a chose in action cannot be assigned to the detriment of the debtor, nor can he be forced to pay some one other than the person he originally promised to pay. Suppose A owes B $100 and B, in turn, owes A $25 in connection with a different transaction. If B sues A, he can recover only $75, for to B's claim for $100 A can make a counter-

claim of $25. Therefore, if B assigns his claim of $100 to C, C can collect only $75 from A, for A can counter-claim for $25. C will then have to collect the extra $25 from B for B's breach of implied warranty. But if A had acquired the right to get $25 from B after A had learned of the assignment to C, then he would have no right to counter-claim against C for $25. This would be a defense arising after notice of the assignment had been received and would not be good.

Partial Assignments—Not only may a creditor assign his whole claim to an assignee, but he may also assign part of it. A partial assignment authorizes an assignee to collect that portion of the claim assigned and to keep it for himself. However, a debtor is not bound to pay the claim piecemeal; he may insist on making but a single payment unless his contract with his creditor provides otherwise. In accepting a deposit, a bank contracts to pay that deposit in such amounts as the depositor may indicate on the checks drawn by him, but an ordinary debtor cannot be required to pay in such amounts as his creditor may see fit to demand. A few courts hold that, even if he has notice of a partial assignment, the debtor may pay the whole debt to the original creditor although his action may result in defrauding the partial assignee. Most courts, however, hold that the debtor cannot do this when he has been notified of the facts and that if he objects to paying fractional parts of his indebtedness, he must pay the whole sum into court to be distributed by it among the parties entitled to the claim.

Assignment of Future Claims—Assignments of future claims, as well as of existing claims, may be made, but in many states there are special provisions of the statute law in regard to such assignments. The assignment of future wages is usually required to be recorded. Generally the law does not allow the assignment of a future claim unless the contract or the employment out of which the claim is expected to arise has already been made or is already in existence.

Assignment of Duties—The duties under a contract are not assignable under any circumstances; that is, one who owes money or is bound to a performance cannot, by any act of his own or by any act in agreement with any other person except his creditor, divest himself of liability and substitute the liability of another. If this were not so, debtors would find it an easy matter to escape from their debts by assigning to irresponsible persons the duty to pay. But although a person who is subject to a duty cannot escape liability, he may delegate the performance of his obligation, provided the duty is of such a character that performance by an agent will be substantially the same thing as performance by the obligor himself. Thus, one who owes a mortgage may delegate the payment of the mortgage to a purchaser of the land who assumes the liability and agrees to pay the debt. If the purchaser of the land actually pays, the debt is discharged; but if he fails to do so, the mortgagee may still sue the original mortgagor. The mortgagee may also sue the purchaser of the land if he chooses to do so, since he is a creditor

beneficiary on the contract between the mortgagor and the purchaser. Similarly, where a partnership is changed and a new firm formed, it is a common practice for the new firm to assume the obligations of the old firm, although a creditor may still insist upon holding the members of the original partnership.

Assignment of Bilateral Contracts—In bilateral contracts each party is under a duty to perform his promise, but he also has a right to the performance of the other party. In the assignment of such a contract, the assignor delegates to the assignee the duty of performing the assignor's promise, but the assignor himself still remains liable if his agent, the assignee, fails to carry out the duty. Furthermore, the assignor authorizes the assignee to receive the payment or performance due from the other party to the contract and to keep it for himself. The assignment of a bilateral contract, therefore, involves both the delegation of a duty and the assignment of a right.

JOINT, SEVERAL, AND JOINT AND SEVERAL OBLIGATIONS

Promises by Two or More Persons—It is not uncommon for two or more parties to bind themselves to the performance of one act. Thus A and B may promise to pay X $100. The promise is not that A and B shall each pay X $100, nor that they shall pay X $50 apiece, but that both together shall pay X $100. The most common instances of such promises are where two persons act as sureties or as partners, but they need

not stand in either of these relationships in order to make such a promise. Obviously X is entitled only to the sum of $100. But what kind of a right does he have to this sum? Must he sue A and B together? or may he sue them separately? The common law originally laid down certain rules which have now become modified by statute in the different states.

At common law such a promise as that cited in the preceding paragraph creates a *joint duty*. A and B are considered to be bound as a single person. There is only one right and that lies against both of them; consequently they have to be sued together.

Under the common law it is also possible for A and B to promise *severally* to pay X $100 for the performance of a certain act. In this case only one performance of $100 is due, but X has two rights to this performance. In a several contract there are as many rights as there are debtors. X can sue either one of the debtors, but he cannot join them in one suit.

A third situation is possible, namely, where A and B promise *jointly and severally* to pay X $100. Again only one performance of $100 is due, but the legal situation created is a combination of the two previous situations. X has both a joint right and two several rights to the performance, so that in a joint and several contract there are as many rights as there are debtors plus one. X can treat the contract as joint or as several for purposes of suit; he can sue the debtors together or he can sue them individually.

If two or more parties promise to pay a single sum, at common law they are presumed to do so jointly. Of

course, express words in a contract will show that the parties assume a different kind of an obligation, but if they simply sign their names to an obligation, they become joint debtors. Thus a partnership obligation is ordinarily a joint obligation.

Survivorship—One important consequence flowing from the character of the obligation assumed at common law is the rule of survivorship. Joint duties survive to the survivor. Thus if A and B jointly promise to pay X $100 and A dies before the obligation is met, the obligation to pay survives to B and no legal liability rests upon A's estate. There is no such rule of survivorship in the case of a several obligation. Therefore, if A and B severally promise to pay X $100 and A dies, X can sue either B or A's estate. In a joint and several obligation the joint obligation rests upon the survivors, while the several obligation remains unaltered. Thus if A, B, and C are jointly and severally indebted to X for $100, all are bound jointly and each is bound individually. If A dies, only B and C are jointly indebted to X, although A's estate, B, and C are still severally indebted to X.

Judgment against One Debtor—A second important feature of the character of the obligation relates to the effect of a judgment against one debtor. A judgment under the law operates to destroy the old right and to create a new right. Thus, if A sues B upon a promise for $100, he is asking for a judgment upon his contract right against B. But once A obtains his judg-

ment against B, the contract right is gone, and a new right created by the judgment takes its place. Upon the judgment A can get execution or an order from the court directing the sheriff to sell B's goods so as to satisfy the judgment claim.

Since a judgment operates to cancel a prior right, if A secures a judgment against B, one of two joint debtors, he cannot thereafter sue the other, C, even though he never succeeds in getting his judgment satisfied. There was a contract right against both B and C, but A's judgment against B alone has destroyed that right and given A a right only against B; consequently there remains nothing upon which to sue C. In the case of several obligations, on the other hand, there are as many contract rights against the several debtors as there are debtors. Consequently a judgment against any one of them does not prevent the creditor from thereafter suing the others if his judgment is not satisfied. The same rule applies to joint and several debtors.

Release of One Debtor—Most of the difficulties relating to the joint and several obligation arise from a release given to one of the debtors. A release, like a judgment, operates to destroy the old right. Thus a release of one joint debtor operates to release all of them, for there was only one right and that is destroyed by the release. The creditor may have had an entirely different intention, but the effect of his release is determined by the law. Since in a several obligation there are as many rights as there are debtors, a release of one debtor simply destroys the right as against him but it

does not affect the creditor's rights against the other debtors. In a joint and several obligation it would seem that a release of one debtor would merely destroy the joint right and several right against that debtor, leaving outstanding the several rights against the other debtors. However, the law provides otherwise; a release of one joint and several debtor also discharges the rest of them.

Release with Reservations—There is, however, a very simple legal device which avoids the unfortunate effect of releasing all the debtors by releasing one joint debtor or one joint and several debtor. This device is the release with reservation of rights against the other debtors. The creditor avoids the legal effect of releasing all of the debtors if, in his release of one of the debtors, he includes a statement to this effect: "This release is not to affect my rights which are hereby reserved against the other debtors."

Statutory Changes—The rules of the common law governing these three groups of obligations are obviously very technical and artificial. For this reason statutes have been adopted in nearly all states to modify the common law. Many states have abolished joint duties entirely and have provided that all such obligations shall be joint and several. Some states have simply provided that any common obligation which is assumed shall be presumed to be joint and several. Several states have passed statutes to do away with the rule that a judgment against one joint debtor prevents the creditor thereafter from suing the other debtors.

CHAPTER V

Contracts—Performance and Termination

THUS far we have considered the elements which are necessary for the formation of a contract, the parties to contracts, and their capacity to make contracts. We must next consider the circumstances under which a party to a contract may sue. When is a contract broken? When has one party to a contract conducted himself in such a fashion as to excuse the other party from performing? Must one party perform on his side before he can sue the other party for not performing? What occurrences which make it impossible for a party to perform the obligation he assumed will relieve him of liability for not performing? These are some of the questions which continually arise and to which answers must be found.

Express Conditions in Contracts

Conditional Contracts—What one agrees to often depends on the conditions which he includes as part of his promise. A typical conditional contract is found in the fire insurance policy. A fire insurance company promises to pay $5,000, but it does not promise to pay in any event; the express condition "if the house burns down" is obviously a qualification of the promise. There may be other conditions in the insurance policy. The insurance company may say that it will not be liable if gasoline is kept in the house beyond a small quan-

tity necessary for cleaning. "If the house burns down," "if gasoline is not kept in the house," "if the house does not remain unoccupied for more than three months," and "if mechanics are not allowed in possession of the property for more than a certain length of time" are some of the conditions which may be included in the contract. The company's promise to pay is expressly made dependent upon the performance of these various conditions, and unless they are complied with there will be no liability on the part of the company.

It is obvious that these conditions in promises may be used sometimes to defeat the ends of justice. Performance of the condition may have become absolutely impossible due to no fault of either party. Despite the fact that the condition has not been performed, must the other party pay? The other party promised to pay only if the condition were performed. Since that was his promise, should the law impose any other obligation upon him? Should not the law simply enforce the contract as the parties made it without attempting to remake the contract for them? Suppose a fire insurance policy stipulates that the insured must keep his inventory and books of account in a fireproof safe and in case of fire must produce them before the company will pay for the loss. The insured keeps them in what is known in the trade as a fireproof safe, but an exceedingly intense fire destroys the safe and the books. Can the insured then recover for his loss? Is his failure to perform the condition to be excused? If "fireproof" means not actually fireproof but simply what is generally considered to be fireproof, and "produce" means "produce if

not destroyed," has he complied with the condition set forth in the policy?

Another kind of conditional promise often occurs in building contracts. The employer agrees to pay the contractor on the latter's producing the architect's certificate stating that the specifications have been followed and that the work has been satisfactorily done. The production of the certificate is thus a condition of the employer's promise. The reasons leading him to make such a condition of his promise are obvious. Compliance with specifications is a matter of technical importance, and the employer wants the judgment of an expert as to whether there has been such compliance; he does not want to have that question decided by a jury of twelve men who may be totally unacquainted with the importance of accurately following building specifications. Thus the contractor must obtain the certificate from the architect in order to get his money. Suppose, however, that the house has been properly built but that through ill temper on the part of the architect the certificate is withheld, or suppose that the architect refuses to give the contractor a certificate unless the contractor gives the architect a certain percentage of his pay. The condition will not have been performed. But will its performance be excused so that the contractor may claim his pay?

Principles Governing Non-Performance of Conditions—The law always operates on the premise that conditions must be performed. Even though their performance has become impossible, non-performance gen-

erally will not be excused. However, there are some exceptions to the rule. If the non-performance of one party was the result of some act of the other party, the latter cannot insist upon the fulfilment of the condition. Thus, if it could be proved that the employer in the building contract case had induced the architect, for unworthy reasons, to withhold the certificate, the contractor could recover without having produced the architect's certificate.

Another exception is that non-performance will be excused where an innocent promisee would otherwise be subjected to a substantial forfeiture. Thus, in the insurance case the purpose of the fireproof safe condition is to protect the insurance company against fraudulent claims by persons whose stores have been burned, when it has become practically impossible for the insurance company to prove the extent of the loss. By making the production of an inventory and books of account a condition of the insurance contract, the insurance company has available a means of checking the loss, except in unusual circumstances, and the insured makes every reasonable effort to furnish the company with proofs of the loss. In cases where the insured has made every reasonable effort to keep the proofs of his loss, the purpose of the condition has been effected. Its non-performance therefore is excused, for otherwise there would be a real forfeiture.

In the building contract case, also, the contractor had done everything in his power. He chanced securing the architect's expert judgment but not his ill will nor his dishonesty. By excusing non-performance of

the condition under such circumstances, an unexpected forfeiture is relieved against, while the reason for inserting the condition is respected. In all cases where a substantial forfeiture is not involved, however, the stern rule that conditions must be performed under all circumstances is rigidly observed.

IMPLIED CONDITIONS IN AND REPUDIATION OF CONTRACTS

Primary Rule—The primary rule of law governing obligations to perform contracts is that if a man has once formed a good contract, he must do as he agreed; if he fails substantially (not merely slightly) to do so, the other party may refuse to perform on his part. If this fundamental principle is kept in mind, one cannot generally go far wrong.

One Performance to Precede the Other Performance—Where the performance promised by one party to a contract is to precede in point of time the performance by the other party, the party who is to perform first is bound absolutely to perform, whereas the party who is to perform subsequently may refuse to perform unless and until the other party performs. The most common illustration of this principle is to be found in the ordinary employment contract. Suppose A promises B $5 and B, in turn, promises to mow A's lawn. B cannot demand the money after he has partly mowed the lawn even though he is willing to finish it after being paid. A is not bound to pay until the work has been

entirely finished even though he did not expressly qualify his promise by the statement that the work was to be done before he would be bound to pay.

It has been dictated by custom, rather than by any definite rule of law, that where work is to be performed on one side and money is to be paid on the other, the work must be done before the pay is given unless there is a statement in the contract to the contrary. B must work anyway since his promise to work is absolute. On the other hand, A's promise to pay the money is conditional; its fulfilment is subject to the implied condition that B shall have done the work he agreed to do. A's promise is, in effect, "I will pay when you have done the work," but B's promise is "I will work." B has to trust to the integrity of A for his pay.

Performances Concurrently Due—Frequently there arise cases where the performance of both promises can take place at the same time. The most common illustration of the principle here involved is found in the contract to buy and sell. In a contract where the price can be paid by one party and the goods delivered by the other party simultaneously, that is, where both performances can be rendered at the same time, the rule is that they must be rendered simultaneously in the absence of agreement to the contrary.

A agrees to buy B's horse and pay $200 for it, and B agrees to sell the horse for $200. This is a bilateral contract of purchase and sale. If neither party does anything, has each party broken his promise? It may seem so, for A has not bought the horse as he agreed,

nor has B sold the horse. But where one party is bound to perform simultaneously with the other, he must do what is called putting the other party in default if he wants to acquire any rights under the contract; that is, he himself must offer to perform. A, therefore, must go to B, offer $200, and demand the horse if he wants to assert that B has broken his contract. On the other hand, if B wishes to enforce the contract, he must take the horse to A and say, "Here is the horse which I will hand over to you on receiving simultaneously the $200 which you promised me for it."

The obligation of two promises which can be performed simultaneously is called concurrently conditional, that is, each party has a right to concurrent performance by the other, and each has a right to refuse performance until he receives, concurrently with his own performance, performance by the other party.

Materiality of Breach—Our next problem is concerned with what kind of conduct amounts to a breach which will not only excuse the other party from performing but will also give him a right to sue for the breach. The general principle is that the breach must be material or substantial, but what constitutes materiality is often a difficult question to decide.

Suppose an agreement for the sale of real estate requires the price to be paid and the title to be conveyed on a certain day. The buyer is unable to be on hand the day the sale is to be completed but comes to the owner the next day, tenders the money, and requests the land. Can the owner refuse to convey? or must he

convey and then bring an action to recover whatever damage he has suffered by the delay? The buyer has certainly broken his promise, but such a brief delay would not be considered sufficiently material to justify the seller in refusing to go on with the contract. A longer delay, however, would excuse the owner from being liable to convey; if the owner had been ready and willing to convey on the date specified and had been prevented from making a tender only by the buyer's non-appearance, he would have an action against the buyer for the latter's breach of contract. As to how many days would be sufficient to excuse the owner from performing, one must judge by considering the fluctuating value of the land, the importance of the time element to the particular parties, whether or not the circumstances were such as to induce the owner to believe that the buyer would not perform, and whether the owner reasonably took action to guard himself against what looked like a permanent breach on the part of the buyer.

In contracts for the sale of personal property, the rule is generally adhered to strictly so that any delay becomes material. The fluctuating value of personal property is responsible for the distinction. Certainly in a sale of stock of a speculative character a delay of half an hour might well be material. Time here is said to be of the essence of the contract, which means that the time element becomes of vital importance.

Breach after Part Performance—More difficult problems, however, arise when the breach occurs after

part performance. Suppose that A agrees to build a house for B and to complete it by a certain date or to paint it with a certain quality of paint. Suppose further that A fails to complete the house by the time specified or that he uses an inferior grade of paint. If A's breach under either of these circumstances is to excuse B, not only will A lose the benefit of a seemingly good bargain, but he will also lose the value of the work he has already done. Consequently the breach by A will have to be quite material in order to excuse B. If B can be compensated for the delay or for the defects by a reduction in the purchase price equivalent to the loss he has suffered, the courts will hesitate to regard the breach as material. The difference between the factors involved in a breach before any performance and those involved in a breach after part performance must be borne in mind when considering whether the breach is material.

Contracts of Service—Similar questions arise frequently in contracts of employment. Suppose an employer hires an employee for a year, and in the course of the year the employee at some time or other fails to fulfil his contractual duty as an employee. He is negligent and fails to comply in some respects with his contract to render good and efficient service. Can the employer discharge him? It is a question of how material the breach is. A merely negligent or unintentional breach of duty is not so serious as one which is wilful.

There might also be a breach on the other side of

the contract. Suppose the employer has promised to pay a certain sum each month during the year as salary and he does not pay promptly. Has the employee a right to say, "You'll pay my salary on the first day of the month as you agreed, or I'll leave"? The delay of a single day in the payment of one month's instalment of salary would not justify the employee in throwing up a year's contract. On the other hand, if the delay ran along for any considerable time, the employee would be justified in refusing to continue his services.

Instalment Contracts — Many difficulties may arise in connection with instalment contracts. Suppose a manufacturer makes a contract for the delivery each week of a certain number of bales of cotton for which he agrees to pay a specified price per bale on delivery. The contract covers the period of one year. If the manufacturer fails to pay for one lot on delivery, what can the seller do? If the delay in payment is only for a few days, the seller certainly has no right to refuse delivery of any cotton and to sue the manufacturer for breach of the contract. Suppose, however, the manufacturer has failed to pay for one instalment by the time the next delivery is due. In such a case the seller can refuse to deliver the next instalment until the previous one has been paid for, but if the manufacturer pays up within a reasonable length of time, the seller must continue to deliver the goods. A mere temporary delay in payment by the manufacturer would not justify the seller in refusing to deliver any more cotton and in suing the manufacturer for breach of the contract. It

therefore becomes a matter of judgment as to what length of delay constitutes a material breach, and one's judgment must be based on such factors as the necessity for prompt trade, the manufacturer's attitude, and the character of the goods.

Delay by the seller in the delivery of an instalment is treated in the same manner as delay by the buyer in the payment of an instalment. Whether the buyer will be justified in refusing to take any more goods depends upon the materiality of the delay. In mercantile contracts involving instalment selling, promptness in delivery is generally more important than promptness in payment. If the seller delivers goods of an inferior quality in one instalment, the buyer will be privileged to refuse to take these inferior goods. Whether the buyer would be entitled to refuse to take any more goods, even though the next instalment offered were not inferior, depends upon the materiality of the breach by the seller. The amount of goods below standard and the degree of inferiority are factors to be considered in determining whether the breach is a substantial one. Even though the breach is not substantial and the buyer is required to continue to take goods of standard grade offered him by the seller, nevertheless the buyer can get damages for this breach.

Prospective Inability of One Party to Perform—A seller may agree to deliver a specific article to a buyer at some future date, but before that date arrives he may dispose of the article to a third person. Thus far the seller has not actually broken his contract; he may be

able to perform it by buying the article back from the third party before the date specified and by tendering it to the original buyer on time. However, the likelihood of such a happening is rather remote, and the original buyer has just cause to believe that the seller is not going to perform as he promised. Such a situation is described as a prospective inability to perform, in which case the buyer is entitled to act to protect himself from the impending breach of contract. If he does so by buying the article from some one else, he cannot be compelled to perform on the day specified. If, however, the buyer takes no action upon the occurrence of the prospective inability and the seller tenders the article on the day specified, the law will insist that the buyer perform according to the terms of the original contract.

Other instances of prospective inability are found in connection with bankruptcy and insolvency. Suppose a warehouse enters into a contract to sell a merchant 100 barrels of flour on thirty days' credit. The time for the delivery of the flour arrives, but the merchant is insolvent. He says to the warehouse, "I want you to deliver that flour; the day agreed upon has come." The warehouse replies, "But you cannot pay for the flour." "Well," says the merchant, "it is not time to pay for it. You agreed to give me thirty days' credit and perhaps I shall be able to pay by the end of the credit period. I have not yet broken my promise, and so long as I am not in default in my promise, you have no right to break yours." The warehouse has a right to refuse to deliver the flour because, although the buyer has not yet broken

his contract, the prospect of his being able to keep it on account of his insolvency is so slight that his prospective inability to perform in the future excuses the warehouse from performing now. However, if the merchant offers to pay cash for the flour or gives security for its payment in thirty days, then the seller will be required to deliver the goods, for the buyer will have removed his prospective inability by his affirmative act. If the buyer becomes bankrupt, he must take such affirmative action in order to compel the seller to perform and thereby to preserve for himself the benefits of his contracts.

Anticipatory Repudiation—It not infrequently happens that before the date set for performance one party to a contract will announce to the other party that he does not intend to perform. Such a statement is known as anticipatory repudiation. What may the other party do in such an event? As in the case of prospective inability, he may act upon the repudiation and take measures to protect himself from the threatened breach. Having taken such measures, he is justified in not performing even though the repudiating party retracts his refusal and tenders performance on the date specified. However, if he does nothing and the repudiating party does not retract his anticipatory repudiation, there is a difference of opinion as to whether the other party must tender performance on the date set in order to put the repudiating party in default and thus make him liable to a suit for breach of contract. If the latter retracts his repudiation, then

a tender must be made to put him in default. If the repudiating party tenders performance, the other party must perform if he has not acted upon the repudiation.

Suit for Anticipatory Breach—In most states the party who receives notice that the other party will not perform on the day set may immediately bring a suit for damages, instituting that suit before the day set for performance. However, to avail oneself of this remedy, which means treating the anticipatory repudiation as an anticipatory breach of contract, two things are necessary. The anticipatory repudiation must be an absolute and unconditional refusal to perform, and the plaintiff must immediately elect to treat it as such. This election means both that the plaintiff treats the anticipatory repudiation as the final word by the defendant and does not, for example, write back to the defendant requesting him to retract his repudiation, and that the plaintiff as shortly thereafter as convenient institutes a suit for breach of contract. This rule of anticipatory breach does not prevail in a few states, nor does it apply in any event except to bilateral contracts.

DISCHARGE OF CONTRACTS

Discharge of Contracts—Contracts are discharged in much the same way as they are made. The simplest way of discharging a contract is by performing it. When both parties do exactly as they have agreed to do, the contract is discharged by performance. A contract may also be discharged by agreement. Just as contracts may

be made either under seal or by an agreement with consideration, so they may be discharged either by a release under seal or by an agreement for rescission of the contract supported by consideration. The agreement under seal to discharge a contract is called a release. A right for money, a right to have work done, or any right may be so released.

Illustrations—Suppose A has promised to build a house and B has promised to pay $10,000 for it. Before anything has been done, A and B agree to call the contract off. This is a valid agreement for rescission because each party agrees to give up something. One party gives up his right to have the house built; the other party gives up his right to receive $10,000 in payment. Similarly, an agreement between an employer and an employee that their contract shall be terminated before the time originally agreed upon has sufficient consideration. The employer gives up his right to the employee's service; the employee gives up his right to future pay.

Consider a somewhat different case. A owes B $1,000, and they agree to call the debt square. This agreement has no validity, for here only one party agrees to give up a right. The creditor agrees to give up his thousand dollars, but he receives nothing in return for his promise. The debt could be discharged, however, if valid consideration were given for the surrender of the claim by the creditor. Anything agreed upon, a horse, ten shares of stock, or anything else the parties agreed to, would be good consideration for the

promise to surrender the claim, so long as the parties did not get into the difficulty alluded to in connection with the subject of consideration, namely, that of trying to surrender a right to a liquidated sum in consideration of the payment of a smaller sum of money.

Sending a Check as Full Payment—It is very common for a debtor in making payment of his debt by check to seek to make the check operate as a receipt in full of all claims by the creditor against him. He may do this by writing on the check itself that it is "in full of all demands" or "in full payment" of a certain bill, or in a letter accompanying the check he may state that the check is sent as full satisfaction. The acceptance of the check by the creditor under either of these circumstances is an assent by him to the statement on the check or in the accompanying letter that the check is in full payment. Such an assent, however, does not necessarily prove that the debtor is discharged; consideration as well as mutual assent is essential to the validity of any agreement which is not under seal. Accordingly, if the debt is a liquidated and undisputed one and the check is for less than the amount due, the agreement of the creditor to take it in full satisfaction is not supported by sufficient consideration. On the other hand, if the debt is an unliquidated one, or there is an honest dispute in regard to the amount due, the creditor's claim is fully satisfied by his assent.

Receipt in Full—A receipt in full is often considered by business men as a discharge irrespective of con-

sideration; that is, it operates like a release. However, this is not true in most states. If payment has been made in full, a receipt in full is good evidence that payment has been so made; but where payment has not been made in full, a receipt in full will not be effectual without consideration, as a release under seal would be.

Renunciation of Obligation on Negotiable Instrument—There is one exception to the rule that the law will not allow a party who has a right to surrender it without consideration unless the release is given under seal. The Negotiable Instrument Law provides that the holder of a note may discharge any party to it by a written renunciation of his claim. No consideration is necessary and no particular form of words is necessary; the only requirement is that the renunciation must be in writing.

Alteration of Written Contracts—The alteration of a written contract, in a material particular, by a promisee with fraudulent intent has the effect of discharging the contract so far as he is concerned. He cannot enforce it either in its original form or in its altered form, although the other party to the contract may enforce it against him. If the alteration is not material, the contract may be enforced even by the party who altered it no matter what the motive for the alteration may have been. If the alteration is material but not fraudulently intended, the party altering the contract is generally allowed to enforce it in its original form. Alteration by a third person does not affect the rights

of the parties to a contract. A material alteration is one which, if given effect, would alter the legal obligation of the parties to the contract. The rule of the Negotiable Instruments Law in regard to alteration of negotiable instruments, it should be observed, is somewhat more severe than that generally prevailing in regard to other contracts.

CHAPTER VI

Defenses to Contracts

ONE of the most common defenses to contracts is fraud. Fraud is deception resorted to by one party for the purpose of inducing the other party to believe something which is not true, thereby influencing his action. In contracts fraud is generally perpetrated by a misrepresentation of material facts. A purchase or sale of stock or of goods brought about by misrepresentation of material facts is fraudulent.

Misstatements of Opinion Are Not Fraudulent — What kind of misrepresentation amounts to fraud? There must be misrepresentation of fact. Misrepresentation of opinion alone is insufficient, but what is opinion and what is fact have been the basis of a good many law suits. Suppose that A offers his horse to B for sale at $300 and says that it is the best horse in town. Even though it is far from the best horse in town, that statement cannot become the basis of an allegation of fraud. A statement that a thing is "good" or "the best on the market" is not a statement of positive fact; it is simply an expression of opinion and should be recognized as such by the hearer.

If A says, "This horse can trot very fast," he is making merely a statement of opinion. To some minds a speed of eight miles an hour is very fast; to more enterprising persons a speed of fifteen miles an hour is necessary in order to make travel seem fast. In other

words, it is a matter of opinion. But if A says, "This horse can trot twelve miles an hour," or "This horse has trotted one mile in three minutes on the track," he is making a statement of fact, which if found to be untrue is fraudulent.

A statement of value is a statement of opinion and cannot be the basis of an allegation of fraud. The statement that the horse is worth $300 or that he is worth twice as much as the owner is asking for him cannot be relied upon; but the statement that $300 was paid for the horse or was offered for him is an assertion of fact, which if untrue would be the basis of an allegation of fraud.

Broken Promises Are Not Fraudulent—A promise is not a statement of fact. A man may promise to do something and fail to carry out his promise. In consequence the person he is dealing with may regret the bargain he entered into, but his only remedy is to sue for damages for breach of the promise if it was part of a contract. He cannot assert that merely because the promise was not kept the transaction was fraudulent. However, if a man makes a promise knowing when he makes it that he cannot keep it, he is committing a fraud. Fraud of this kind is found most commonly where a person buys goods on credit, having at the time of purchase an intention not to pay for them, or well knowing that he cannot pay for them.

Statements Must Have Been Calculated to Induce Action—Generally speaking, the fraudulent state-

ment relied on must have been made with the purpose of inducing action. Suppose Smith, who likes to tell large stories, makes certain statements about his neighbor's horse to Jones. Smith does not do this for any purpose except to brag about living near a man who has such a splendid horse, but Jones suddenly takes a notion that he would like to have that horse, so he buys it. It was not legal fraud on Smith's part to tell those lies about the horse, even though they did induce Jones to buy the horse, unless Smith, as a reasonable man, ought to have known that Jones was likely to buy the horse, which might have been the case if Jones had been talking about buying him. In the latter event, Smith's statements would amount to fraud, and it would make no difference that Smith had nothing to gain by lying.

Concisely stated, fraud is a misrepresentation of a material fact, made intentionally or in reckless disregard of the truth, with intent to deceive and actually deceiving the person who relies on the misrepresentation to his damage.

Remedies for Fraud—The law gives the defrauded person two remedies of which he may take his choice; he may not have both, but he may have either one. He may sue the fraudulent person for such damages as have been suffered, or he may elect to rescind the transaction. In the latter case he may recover what has been given or refuse to go on if the contract is still executory.

Duress or Undue Influence—Another defense, similar to fraud but comparatively rare, is duress, or

undue influence. Duress means compelling a person to do what he does not want to do, making him agree to a bargain which he would not agree to except under compulsion, as by fear of personal violence, of prosecution, or of imprisonment. A bargain made under these circumstances may be rescinded or set aside. Merely threatening to enforce one's legal rights by suit against another is not duress, although it may in fact induce him to agree to what he would not otherwise have agreed to; but threatening prosecution as a means of extorting money or of inducing an agreement when no legal rights exist is duress. In many jurisdictions duress is considered a crime.

Impossibility—Impossibility is sometimes a defense to the performance of a contract. In contracts for personal services of any kind, illness or death of the person who promises the services excuses performance. Except for personal services, however, death does not terminate a contract nor serve as a defense to it. If a man dies the day after he has contracted to sell 100 bushels of grain, his estate is liable on the contract just as if he had continued to live; but if he has agreed to employ a certain individual for the period of a year, the employee's death within the year will terminate the obligation of both. Similarly, if a contract is made for the sale of a specific thing, such as a horse, and the thing is destroyed without the fault of either party before the day set for performance, the consequent impossibility of performance is an excuse.

Prevention by the law is also a type of impossibility

that constitutes a defense. Thus, if A contracts to build a house but is prevented from performing by an embargo laid by the government against building, he is excused. However, unexpected difficulty is not impossibility. Suppose a builder agrees to put up a building within a certain time but is prevented by strikes from completing it on time. He is nevertheless liable for not doing as he agreed. He should have qualified his agreement to build by providing that if strikes should occur, he would not be liable for the delay. So also, if the foundation gives way and the building tumbles down before it is finished, or if the building is struck by lightning and destroyed, the builder must put it up again.

Illegal Contracts—In dealing with illegal contracts we must consider what kinds of contracts are illegal and what legal results flow from the fact that they are illegal. So far as the legal results are concerned, it is commonly said that illegality makes a contract void or voidable, but a better way of putting it would be that the law will aid neither party to an illegal contract. If the contract has not been performed, neither party can bring an action against the other to compel him to perform. If one party has performed and the other party refuses to perform, the party who has performed cannot bring an action against the other party either to compel him to perform or to get back the value of the performance that has already been rendered.

Some kinds of illegal contracts are so obviously illegal that it is not necessary to say anything about them—for example, contracts to steal or to murder or

to take part in a crime. Other kinds of illegal contracts, however, are not so obviously wicked as to make it clear that they are unenforceable. In considering the various kinds of illegality, one general principle should be borne in mind. It is not necessary for the parties to know that the law makes their contract illegal; their ignorance of the law is no excuse, and they are treated as if they knew the law. Thus, in states where a Sunday contract is made illegal by statute, it is immaterial whether or not the parties know of this statute.

Contracts in Restraint of Trade—Illegal contracts which have become very important in business of late years are contracts in restraint of trade. Originally a contract in restraint of trade was one by which a man agreed that he would not thereafter exercise his trade or profession, the object generally being that the promisee should be freed from the competition of the man who had promised to refrain from exercising his trade. A good many years ago the law became settled that if the promise was general in nature, that is, not to exercise the trade or profession anywhere or at any time, it was illegal, but that if it was only for a reasonably short time or within a reasonably limited area, it was not illegal. The old law still exists, but there has grown up a much more important class of cases where contracts are made to further an attempted monopoly. Broadly speaking, all such attempts are illegal. No matter what business reason there may be for it, any attempt to combine in order to obtain a monopoly or in order to raise prices is bad. Moreover, if the attempted restraint of

trade or monopoly concerns interstate commerce, the agreement is a federal crime under the Sherman Anti-Trust Act.

Gambling Contracts—Another kind of illegal contract is a gambling contract. This seems obvious in agreements for the more extreme kinds of gambling, but in certain classes of business transactions, the dividing line is not so clear. This is especially true in dealings on stock exchanges and exchanges for sales of staple products, such as grain, cotton, and coffee. The stock exchanges and other exchanges are made the means of a great deal of speculation that sometimes becomes plain gambling. In what cases does the law regard these transactions as gambling and therefore unenforceable? and in what cases does the law regard them as legal? If an actual delivery of the stock or commodity bought is contemplated, then the transaction is not gambling in the legal sense; but if a settlement merely of the differences between buying and selling prices is contemplated as the only performance of the bargain, then the transaction is gambling.

The difference between what is legal and what is illegal in buying and selling stock and commodities is the difference between a stock exchange business and a bucket shop business. If you give an order to a stock broker to buy stock, even though you can put up but a small margin and the stock broker knows you can put up but a small margin, the stock broker nevertheless actually buys that stock and it is delivered to him. The stock broker then has a right to demand that you pay

for the stock in full and take delivery of it, and he can sue you for the price if you fail to comply with his demand. As a matter of fact, a stock broker does not ordinarily do that. If he wants to get the price which you promised to pay and you fail on demand to take up the stock, he sells the stock which he has been holding as security. The bucket shop, on the other hand, does not actually buy the stock although it takes your order to buy; it simply settles with you when you want to settle, or when it wants to settle because the margin is not kept up, by calculating the difference between the price at which the stock was supposedly bought and the price at which it is supposedly sold, these prices being fixed by the ruling market quotations at the time.

It would be quite possible to make a gambling transaction out of a stock exchange transaction by a very slight change. For instance, if a stock exchange house should agree that the customer would not be compelled to take delivery of the stock, then that added agreement would make the transaction between broker and customer a gambling transaction, even though the broker actually bought the stock on the exchange, and, as between himself and the other broker with whom he dealt, there was a valid sale of the stock. In some states, by statute, speculative contracts which are not gambling contracts at common law are made illegal.

Breach of Fiduciary Duties—Another very important class of illegal transactions arises from breach of fiduciary duties. A fiduciary is one whose obligation is more than a mere contractual obligation; it involves

something of trust and confidence. A trustee is a fiduciary, so is an agent or a director or an officer of a corporation. Any dealing in which a fiduciary violates his duty to the person for whom he is fiduciary is illegal, and any contract for such a violation is an illegal contract. It is illegal for a trustee to bargain for any personal advantage from his trust other than his regular compensation. It would be illegal for a trustee to bargain with a bank to give the bank a trust account in return for some personal advantage, as for a loan to be made to the trustee personally. It would be a breach of fiduciary duty for an officer or director of a corporation to bargain for any personal advantage by virtue of his official action.

Commercial Arbitration—Commercial arbitration generally means referring a controversy to arbitrators for determination instead of going to court about it. The arbitration agreement provides for the method of appointing the arbitrators, either that the parties shall select them or that they shall be designated from a board of arbitrators of some chamber of commerce or board of trade. Unhampered by the technical rules accompanying a suit at law, the arbitrators determine the controversy and make an award which will be enforced by a law court. An agreement to arbitrate may cover an existing controversy or it may seek to cover controversies that may arise in the future. For example, by means of a clause inserted in a contract, the parties may agree to submit to arbitration all controversies that may arise under the contract.

The purpose of arbitration is to facilitate the settlement of commercial controversies. The fact that the courts are so crowded that it takes a long time to finish a law suit, that court procedure is unduly technical and cumbersome, that the parties believe that the controversy can be settled better by persons possessing expert knowledge of the subject matter, that bringing a law suit means increasing the bad feeling between the parties while arbitration with its informality and lack of publicity provides a more friendly solution—all these considerations have made business men incline favorably toward arbitration and have made them seek to promote it by legislation and by organizing a procedure and form for arbitration in the various industries and trades.

The Common Law of Arbitration—The common law regarded arbitration agreements with deep suspicion. Thinking of them as attempts to oust the courts of their jurisdiction, judges laid down the rule that arbitration agreements were illegal. Hence, even though a party had agreed to arbitrate, he could break that agreement with impunity and could immediately bring a suit against his former opponent in a law court in violation of the arbitration agreement. The arbitration agreement was revocable at the will of either party, but it could be revoked only before an award had been made. If the parties had agreed to arbitration and if the arbitrators had been appointed and had gone so far as to render an award, there could then be no revocation, and the award would be enforced by a court.

The common law rule that contracts to arbitrate were illegal became modified in one respect. If the agreement to arbitrate was carefully drawn and expressed as a condition precedent to the right of either party to sue on the contract, neither party could sue at law without showing that he had made an honest attempt to have the controversy settled according to the arbitration clause. However, for the arbitration agreement to be effective as an express condition precedent, it had to give the arbitrators a limited authority. The parties could agree in this fashion to submit to arbitrators the question of the amount of damages, but they could not make an enforceable agreement to submit all matters in dispute to arbitrators.

In every case, if an award had been made, that award would be enforced. The grounds upon which a party could resist the enforcement of the award were that the arbitrators had been fraudulent, that they had acted outside the scope of their authority as defined in the agreement to arbitrate, or that they had refused to give the party a proper opportunity to present his case.

Statutory Changes—For all practical purposes the common law thus robbed the arbitration agreement of any effectiveness. The desire to make it effective led public-spirited business men to advocate the passage of legislation that would alter the common law doctrine. As a result, statutes have been passed in recent years to make arbitration agreements enforceable. The statutes fall into two classes: (1) those covering agreements to arbitrate future as well as existing controversies, like

the New York and Federal Arbitration Acts; (2) those relating only to agreements to arbitrate controversies that have already arisen, like the Illinois Act or the Uniform Arbitration Act. These statutes affect the agreement to arbitrate in three ways:

1. They make it legal and thus prevent a party who has agreed to arbitrate from breaking his contract and suing at law. If he does sue in breach of his agreement to arbitrate, that breach is a good defense to his action.

2. They provide machinery for enforcing the agreement to arbitrate. Thus, if one party refuses to arbitrate and to appoint an arbitrator as he is required to by the agreement, the other party can obtain a court order requiring him to appoint an arbitrator. If he still fails to do so, the court itself will appoint an arbitrator.

3. They make the award enforceable by the court on motion of one of the parties and limit the grounds for which the award can be attacked to specific causes such as fraud, dishonesty, and want of authority.

The arbitration agreement once made thus becomes readily enforceable. Before inserting an arbitration agreement in a contract, however, one should decide what kinds of controversies are likely to arise under the contract, whether they can be determined best by a court, or whether, considering the gain in expedition and economy, a tribunal of expert laymen would be better able to determine the rights of the parties.

CHAPTER VII

Quasi-Contracts

THE term quasi-contract is synonymous with contract implied in law. Both terms are unfortunate, for actually there is no such thing as a quasi-contract or a contract implied in law. An illustration will make this point clear. Suppose A mistakenly believes that he owes B $10 and pays it to him. A can recover the $10. In case of suit, A is said to sue B in quasi-contract or upon a contract implied in law; that is, B is treated as if he had made a promise to repay the $10 to A. Actually B made no such promise. There is actually no contract in the real sense of the term, nor is there a quasi-contract, except in the sense that the situation is one where quasi-contractual relief is afforded. A quasi-contract or a contract implied in law is a term used to describe a situation where one party is under a quasi-contractual obligation.

Quasi-Contractual Obligations—A quasi-contractual obligation is an obligation imposed upon a party to restore a benefit which he has received or to restore its value. One sees immediately that this differs radically from a contractual obligation which requires a party to make good his promise. Thus, if A agrees to buy B's horse for $100 and B delivers the horse to A, A's obligation to pay the $100, which can be enforced by an action in contract, is his contractual obligation. But if the law should impose upon A an obligation to

restore the horse or to restore its value, this would be a quasi-contractual obligation.

Historical Conceptions—This conception of quasi-contractual obligations is different from that developed at common law. The common law developed a class of contracts implied in law on a purely arbitrary basis. Historically the obligation to pay a judgment and the obligation to pay a fine imposed by law were regarded as quasi-contracts. Many writers and courts still speak of this class of obligations as quasi-contracts, but such a use of the term is confusing. It is best to limit our conception of quasi-contracts to cases where the defendant's obligation is to restore a benefit which he has received or to restore its money equivalent.

Law and Equity—A suit at law usually ends in a money judgment. Consequently, where the enforcement of a quasi-contractual obligation is sought by an action at law, the result is that, unless the benefit received by the defendant is money, the defendant will be required to restore to the plaintiff the money equivalent of the benefit that the defendant has received. An equity court, however, can compel a defendant to restore the exact thing that he has received, but such courts will not ordinarily exercise their power to grant equitable relief unless there is something unique about the thing which the defendant has received. By unique we mean that money damages cannot compensate the plaintiff for the thing which he has lost. Thus, if the plaintiff had given the defendant a painting of one of

the old masters, which no amount of money could buy, and the defendant was under an obligation to restore it, a court would exercise its equitable power and compel the defendant to restore the painting. Though enforced by equitable relief, the defendant's obligation might properly be termed quasi-contractual in nature. It is common, however, to limit the term quasi-contract to obligations enforced by courts of law as distinguished from courts of equity.

Our next question naturally relates to the circumstances under which the law imposes a quasi-contractual obligation. There are several general types of situations which must be considered.

Quasi-Contractual Relief as an Alternative to Contractual Relief—When the plaintiff has performed his side of the contract but the defendant has inexcusably failed to perform his side, the plaintiff generally has the option of seeking contractual relief or of seeking quasi-contractual relief. Suppose A has mowed B's lawn in return for B's promise to pay $5 which B now fails to keep. A can sue either for the $5 or for the reasonable value of his performance. Where A's performance does not consist of services but of giving B goods, some states insist that A shall seek only a remedy in contract.

Benefit Conferred under a Contract Which Becomes Impossible of Performance—Suppose that A has paid B $100 in return for B's promise to repair A's roof but that before B begins work A's house burns to

the ground. B will not be liable for breach of contract because the impossibility of performance caused by the destruction of the house operates to excuse him for failing to perform his contract, but B must return the $100 he received. A common instance of such a situation is where an ocean carrier receives freight payments in advance and the ship sinks before reaching its destination. The carrier must refund the freight money to the shipper unless the contract provided for the payment of the freight whether or not the goods were delivered. Similarly, if further performance by the plaintiff becomes impossible, he can recover from the defendant the reasonable value of his part performance. For example, if a stenographer were hired for a month for $100 to be paid at the end of the month and she fell sick after two weeks' work, she could recover from her employer the reasonable value of the two weeks' work that she had performed.

Defendant's Performance Unenforceable — A plaintiff may have performed on his side only to find that the defendant's promise is not enforceable because the contract was not in writing as required by the Statute of Frauds. This statute, it will be remembered, does not make the contract illegal but simply unenforceable. In such a case, if the defendant refuses to perform, the plaintiff cannot bring an action on the contract for the contract price, but he can bring an action to recover the reasonable value of his performance. Far different, however, is the case where the defendant's promise is unenforceable because the contract is illegal.

In such a case, unless for some special reason the plaintiff is peculiarly innocent, the law punishes the party who entered into the illegal contract by withholding all aid. He cannot bring an action on the contract, nor can he recover from the defendant what he gave him relying on the fact that the defendant would perform his contract.

Where Plaintiff Breaks His Promise—Suppose that A has agreed to work for B for one month at $100 but that after working for three weeks A stops work without any legal excuse. This would, of course, be a material breach of contract by A for which he would be liable to suit by B. But is A entitled to receive anything from B for his three weeks' work? Ordinarily the courts would refuse to give him anything, but much depends upon the character of the breach. If A wilfully stopped work, he could recover nothing; but if he had a good moral reason though insufficient to operate as a legal excuse, such as going home to attend his father's funeral, the case might well be different. However, some states, no matter what the excuse, would permit A to recover the reasonable value of his work minus such damages as B may have sustained by A's failure to perform in full.

Benefits Conferred under Compulsion—Money paid under duress of person or of property may also be recovered by a quasi-contractual action. If B induces A to pay him $100 by threatening to prosecute A's son for embezzlement, A can recover the money. A is not

legally responsible for the misdeeds of his son, and even though the son had stolen $1,000, A could still recover the $100. So also, if a customs officer wrongfully asserts that A has to pay $100 on his goods and refuses to let the goods through until A has paid the sum, A can get back the money. The most common example of duress of property is where an illegally assessed tax is collected. In the absence of statute, illegally assessed taxes, if paid, cannot be recovered unless there was some compulsion accompanying the payment, even though the payor at the time of payment stated that the taxes were being paid under protest. But if the collector threatened to arrest the person or to seize his property unless he paid, the payment of an illegally assessed tax could be recovered.

Mistake of Fact—Mistake of fact very commonly gives rise to a quasi-contractual obligation to restore the thing received under mistake. Mistake may operate in several different ways. One way, that of preventing the formation of any contract, has already been discussed. See the Peerless case which has been previously cited.

Mistake of Fact Must Be Mutual—Both parties must be laboring under a mistake. Thus if A, a contractor, offers to build a house for B and submits a bid of $10,000, which is accepted, and later A discovers that in estimating the cost upon which he based his bid he erroneously added up his figures so that they totaled $3,000 less than they should have, A ordinarily can have

no relief. This is termed a unilateral mistake, that is, a mistake made by one party to a transaction, and for such a mistake there can be no relief except under very unusual circumstances. Suppose, however, that A agrees to insure a shipment of goods which B states are now on board the steamship Leviathan, but, as a matter of fact, there are no such goods on board the vessel and both parties are honestly mistaken. Either party, because of this mutual mistake, could have a defense to the enforcement of the contract, and B therefore could recover whatever insurance premiums he may have paid A.

To the rule that the mistake must be mutual, there is one important exception, namely, that a unilateral mistake known to the other party will be ground for relief. Suppose A contracts to buy land from B under the mistaken assumption that the land contains seven acres, whereas in fact it contains only five acres. B knows of A's mistaken assumption but nevertheless permits him to act upon it. Although the mistake here is only unilateral, still B's action in selling under the circumstances is somewhat dishonest, and for this reason the courts lend their aid. B cannot enforce the contract against A, and A can get back from B whatever he has paid B. In order to avail himself of this remedy of getting back money paid under mistake of fact, the plaintiff must always tender to the defendant whatever he may have received from the defendant. Courts are very strict in their insistence upon such a tender by the plaintiff as a condition precedent to his right to sue the defendant.

Mistake Must Be Vital to the Transaction—Not every mutual mistake of fact is ground for relief. The mistake must also be vital to the transaction. A mistake as to the existence of the specific subject matter of the transaction would be a vital mistake. Thus, if I took out insurance on my country house and prior to my taking it out but without my knowledge the house was burned, I could recover my premium payment, but I could not enforce the contract of insurance. Mistakes as to value are generally not regarded as vital, although if the discrepancy is very gross, some courts will allow relief. Mistakes as to quality may or may not be vital. If the differences in quality are such as to alter the character of the subject matter substantially, relief may be had. In a certain case where two parties bought and sold a cow upon the assumption that it was a barren cow and was valuable only for butchering purposes, but the cow proved to be a breeding cow and hence useful for quite different purposes, the court granted relief. However, if the parties to a contract bought and sold a horse on the assumption that it could trot a mile in two minutes, whereas it could trot no faster than a mile in two and a quarter minutes, no relief could probably be had.

Mistake Independent of Contract—The same principles govern the recovery of money paid irrespective of the existence of a contract between the two parties. If A pays B $100 under the mistaken assumption that he is indebted to B, A can recover the money he has paid. Similarly, if one gives a newsboy a $5 gold

piece thinking it is a penny, he can recover it. If an employee has been overpaid by his employer, he will have to return the excess payment. In these cases, however, restitution of the money paid is only enforced where, under all the circumstances, such restitution would be just. Thus, if an employee received more than he was entitled to from his employer and, believing that he was rightly entitled to it, he altered his style of living and spent the money, it is very doubtful that a court would require him to return it should he be called upon, a year or two afterward, to restore the money. In such a case, requiring the return of the money would entail a severe hardship on one party. Ordinarily, however, it is no hardship for a person to return money or goods in his possession which he received under a mistake and which he is consequently not entitled to retain.

Mistake of Law—For money paid under mistake of law, as distinguished from mistake of fact, there is ordinarily no relief. An executor who pays a legatee believing that the legatee is entitled to the money, whereas he is mistaken as to the legatee's legal rights, cannot recover the money even though the executor acted under the advice of a lawyer. This principle regarding mistake of law is very difficult to apply, for the reason that courts are divided upon the question of what is law and what is fact. In Connecticut and Kentucky the rule does not apply. In Georgia, South Carolina, and the code states such as California and Montana, the principle has intricate variations. In all states

there are numerous exceptions to the general rule, and these must always be examined before any conclusion can be reached upon the right of the mistaken party to recover his money.

CHAPTER VIII

Agency

FOR the purpose of convenience the subject of agency may be divided into three branches: principal and agent, master and servant, employer and independent contractor. The term agency, when used in the broad sense, indicates a relationship which exists when one person is employed to act for another. At the outset, the principal characteristics which distinguish the agent, the servant, and the independent contractor should be kept clearly in mind. It is difficult to indicate the differences with absolute certainty by definitions, but illustrations may suffice.

A owns an apartment house in New York, but as he is seldom in the city, he employs the real estate firm of Smith & Jones to manage the apartments and collect the rents; they are his agents, authorized to act for him in the premises. A owns an automobile and employs a chauffeur to operate the car for him; the chauffeur is A's servant. A owns a vacant lot in New York and employs the Smith Construction Company to erect on it an office building; the construction company is an independent contractor. All three persons represent the principal, or the master, or the employer, as the case may be. But what is the difference in the character of their representation? An agent is employed to bring the principal into new contractual obligations; a servant represents his master in the performance of ministerial or mechanical acts or services, with no thought of

bringing his master into new contractual relationships with third persons. When a person is employed as a servant to perform ministerial or mechanical acts for another, the master always retains control of the means or methods by which the work is to be accomplished, but there are cases where the master retains no control or right of control over the means or methods by which such work is to be accomplished. In this latter case, the person performing the work is not a servant but an independent contractor.

How Agency May Arise—Agency today, in its broadest sense, is a contractual relationship. A person becomes an agent or a servant or an independent contractor upon the express or implied request of the principal or the master or the employer. Although agency may exist, in so far as third persons are concerned, without any formal contract between the principal and the agent, yet in most cases there is an actual contract between the parties to the relationship. Compensation is not necessarily a requisite, although it is usually an element in the contract. For instance, A may be liable for a negligent act of his son in running his automobile in connection with his business, although the son is acting without compensation. There are four methods by which the relationship of agency arises: (1) by contract, (2) by ratification, (3) by estoppel, (4) by necessity.

Who May Be a Principal?—Any person who has the capacity to make a contract may appoint an agent.

From this it follows that persons who do not possess such capacity cannot appoint agents. At common law a married woman could not appoint an agent, but under modern statutes she can do so. An infant's appointment of an agent, like his contract, is voidable at the election of the infant. Corporations may appoint agents; in fact they cannot act except through agents. The directors of a corporation are just as much its agents as are those whom it especially appoints. A partner is the agent of the other partners; he is also their principal. Thus each partner, acting as an agent, may bind the partnership.

Who May Be an Agent?—Any person may act as an agent; incapacity to contract will not debar a person from being an agent. Hence infants, married women, and even lunatics may be agents or servants whose acts will bind their principals or masters.

Kinds of Agents—Agents are generally divided into two classes, special agents and general agents. A special agent is appointed for a special purpose, such as to sell a particular piece of land, for example. General agents are appointed to conduct all the principal's business of a particular kind and are presumed to have whatever powers are necessary to carry on that business. A cashier is a general agent who is authorized to perform any of the varied acts which cashiers ordinarily perform. A peculiar and uncommon type of agent is the *del credere* agent who guarantees his principal against loss from his, the agent's, transactions. A

commission merchant who guarantees that all the goods he sells for his principal will be paid for is a *del credere* agent. A commission merchant who sells goods in his own name, just as if he were the owner of such goods, is known as a factor.

An Agent Cannot Delegate His Authority—A very important rule in agency is that an agent cannot delegate his authority. If A is appointed to do a certain piece of work, A must do it himself; he cannot, as a general rule, empower B to do it. There are three exceptions to this rule. First, if he is given express permission to delegate his authority, he may do so. Second, if the custom of business is such that the principal must be presumed to have understood that there was to be a delegation, or a partial delegation, of authority, he will be treated as if he had authorized such delegation by virtue of business custom, even though he did not expressly authorize the delegation. Third, delegation may be authorized in connection with what are called ministerial or mechanical acts, that is, acts which involve no exercise of judgment and skill. The principal is entitled to the agent's judgment and skill, but if there are parts of the work which do not require skill and which, from their nature, any ordinary assistant can do, then such acts may be delegated.

Agency by Contract—Concerning agency which arises by contract, little need be said. A contract of agency must possess all of the elements of an ordinary contract, namely, mutual assent, consideration, compe-

tent parties, legality of object, and in some cases a particular form. The general principles of contract law are applicable to this method of forming the agency relationship. The contract of agency may generally be oral as well as written. However, there are a few exceptions to this rule. In the first place, authority given to an agent to execute an instrument under seal must itself be both written and under seal. An oral authority or a written authority not under seal given to an agent to convey land, which must be conveyed by a sealed deed, would not enable the agent to make a valid deed. Where the effect of seals has been abolished, this principle is no longer applicable. Generally an agent orally authorized to make a contract to buy or sell land may bind his principal by entering into such a contract, but under the Statute of Frauds the contract which the agent enters into must be in writing and signed. In some states, however, the statutes require a written authority for such a contract.

Power of Attorney—A power of attorney must often be given to convince third persons that the agent really is an agent, having the powers which he claims to possess. A power of attorney is simply a written statement setting forth the fact that a particular person is the agent of another person and is possessed with the powers stated in the document. The power of attorney may be very broad, giving the agent very wide powers, or it may be narrow, giving the agent or attorney power to do only a specific thing.

So far as the law itself is concerned, many powers

might just as well be oral as written, but it would be difficult to induce third parties to deal with the agent, believing that he had authority, unless he showed as proof of it a written power of attorney. A power of attorney is generally given not because the law requires it but so that the agent may be able to satisfy third persons that he is really the agent. A corporation would not transfer stock without a written power from the holder of record; yet if it should choose to run the risk, there would be nothing illegal in doing so. Any attempt to compel a corporation to transfer stock would be held unreasonable unless the person claiming to be empowered to transfer the stock presented a written authority.

Written and Sealed Powers of Attorney—A witness is not necessary on a power of attorney. Therefore a witness on a power of attorney has the same effect as on any other document where a witness is not absolutely required; if the signature of a document is called in question and the signature is witnessed, the law obtains proof of the signature by calling the witness to testify. No other evidence is permissible until the witness has been produced or his absence accounted for, that is, some adequate reason given for not producing the particular person who witnessed the signature to the power.

It is sometimes more difficult to prove a signature which is witnessed than one which is not. A signature which is not witnessed may be proved by any one who has seen the person sign, or who is familiar with his signature, and who can testify that the signature in

question is his; but a witnessed power of attorney might be difficult to prove if the witness could not be found. The matter of witnesses to deeds and other documents where a witness is not absolutely required may be summarized thus: It is a good thing to have a witness if the witness is reliable, if he is a well known person who can always or generally be reached. It is a bad thing to have as a witness a servant or a person who may be lost sight of after some time has elapsed.

One may also ask how a power of attorney given under seal compares with one without a seal. If the attorney or agent is to execute an instrument under seal, such as a deed of real estate, the power itself must be under seal, but a power to do anything which does not require the execution of a sealed instrument is just as good without a seal as with one. However, if the power contains an agreement by the principal not to revoke the power, this agreement will not be binding if there is neither seal nor consideration, although it will be binding without consideration if under seal, in a state where seals still have their common law effect. In the latter case, the principal will commit a breach of contract if he revokes the power.

A special kind of power of attorney is known as a proxy. It is simply a written power of attorney authorizing an agent to vote as a representative of a stockholder. A corporation would be held justified in refusing to recognize any proxy that was not in writing.

Agency by Ratification—Where the assent of the principal to the act of a self-appointed agent is given

after the act is performed, it is in the nature of a ratification of the act, and the act then becomes binding just as if there had been a previous authority or appointment. Suppose, for example, A and B are acquaintances; both are wealthy. A is a good judge of horses and knows that B likes good horses. A discovers what he considers a good horse and buys it for B at a very low price. The next day he tells B what he has done. B then goes to get the horse and tenders the price, but the dealer refuses to sell, having been offered a higher price. B has a cause of action against the dealer for breach of contract, for by ratifying A's act he has made a binding contract between himself and the dealer.

Similarly, if an agent acts beyond his authority, the principal, if he chooses, may ratify that act. Occasionally, in an emergency, it becomes necessary for an agent who has his principal's interest at heart to take a chance and act beyond the scope of authority given him. If the principal ratifies such an act, he makes a binding contract between himself and the third person, but of course the principal is under no legal obligation to ratify.

Requisites of Ratification—To be effective, ratification, like the appointment of an agent, need be by no formal means. In certain cases we found that the formality of a writing or of a seal was required for the appointment of an agent. In similar cases ratification must always be by a writing or under seal. In order that a principal may effectively ratify an act, the agent must have purported to act as an agent for that particu-

lar principal. If the agent purported to act for himself or for some other principal, his principal can neither ratify nor affirm so as to make a contract with the third party. Furthermore, even though the agent purports to act for a particular principal and that principal is not in existence at the time, the principal cannot effectively ratify the act when he later comes into existence. Hence, if promoters make a contract to purchase property from T, purporting to act as agents for a corporation which has not yet been formed, the corporation, after it is organized, cannot by ratification form a contract with T.

Ratification of part of a transaction cannot be made. Thus if A, purporting to act for B, bought two horses from T, B could not ratify with respect to one horse only; the ratification must be of the whole transaction in order to be effective. Ratification becomes effective when communicated either to the agent or to the third party, and once made it is irrevocable. It dates back to the original transaction so that the result of an effective ratification is just as if the agent had had specific authority from his principal at the time he engaged in the original transaction.

Agency by Estoppel—An accurate conception of the meaning of estoppel is important. An estoppel may be said to have arisen when one party, by conduct or language, has caused another party reasonably to believe in the existence of a certain state of things and the other party has acted on that belief to his detriment. The first party is then precluded from denying the ex-

istence of that state of things to any one who has justifiably relied on his language or conduct. In other words, he is said to be estopped from showing the true state of affairs. Estoppel is effective to create an agency, for if a principal, by his conduct or language, has caused another reasonably to believe that a certain person is his agent and the third person has acted upon that representation to his detriment, the principal will be estopped from showing that the ostensible agent was not actually his agent.

Implied Authority of Agent—Agency by estoppel should be distinguished from cases of implied authority in the agent, that is, where the agent has the power to act for his principal, but the grant of the particular power has not expressly been given. In any general grant of authority to an agent, one has to rely on the course of business and on the nature of the employment to determine the extent of the agent's authority. In the case of a person dealing with the cashier of a bank or with the paying teller or with the president, whether or not the bank is bound by that dealing depends on what general custom or the course of business dictates as the authority of a cashier or of a paying teller or of a president. If cashiers or paying tellers or presidents generally have certain authority, then it is fair to assume that this particular officer has such authority.

Authority to Do Particular Acts—The implied authority of special agents requires some explanation. An agent to sell generally has no authority to make a

sale on credit or to receive anything but money; he cannot barter or exchange the property even in part, nor can he pledge or dispose of the property in payment of his own debts. For the sale of land, an agent's authority ought always to be under seal, and the provisions contained in the power of attorney will be strictly construed. In a sale of personal property, an agent has implied authority to do whatever is usual and necessary in such a transaction. He may receive payment if he has possession of the goods, but not otherwise; he may warrant the quality if such goods are customarily sold with a warranty by agents. He may not sell on credit unless such is the custom, as in the case of commission merchants, nor may he pledge or mortgage the goods. An agent may not buy on credit unless so authorized, or unless it is the custom of the trade; but a principal's direction to purchase without supplying the agent with funds will imply authority to purchase on credit. An agent must purchase precisely as directed.

An agent to manage has an authority co-extensive in scope with the business and possesses the same power and authority as the principal so far as management goes; but the agent may not sell or dispose of a business, nor mortgage the property used in carrying it on, nor engage in new and different enterprises. Public agents, that is, public officers, cannot involve their principals, the municipal corporations whose officers they are, in contract liabilities with third parties unless actually authorized to make the contracts in question, and all persons dealing with such agents must inform themselves of the scope of the agents' legal powers.

Apparent Authority of Agent—In agency by estoppel the agent has neither express authority nor implied authority. As a matter of fact, he has no authority at all so far as the principal is concerned, yet as to persons with whom he deals for the principal he has apparent authority. Suppose that cashiers generally have authority to certify checks. Then any cashier would have an implied authority to do so from the general nature of his position, although nothing may ever have been said about it by the bank directors. But suppose in a particular bank it is a rule, expressly stated and passed upon by the directors, that the cashier shall not have power to certify checks. In this case the cashier has neither express nor implied authority; yet if he should certify a check to any person ignorant of the limitation on his authority, the bank would be bound by the certification because the cashier has apparent authority. He seems to the public just like any other cashier, and the bank, by its act of continuing the cashier in a position where any one would consider him to have authority to certify checks, has represented to the public that he has such authority. The bank would therefore be estopped to deny the cashier's lack of authority to any one who had reasonably acted to his detriment upon the cashier's apparent authority.

Compare the following case with the case of the cashier just alluded to. A man who is giving some support financially to a book dealer writes a note in which he says, "I authorize A (the book dealer) to buy a stock of books not exceeding $5,000 at any one time." The book dealer shows this written authority to persons

from whom he buys books. The last lot of books purchased brings the total well over $5,000 without the knowledge of the seller. Is the principal liable to the person who last sold books to the dealer? The answer is no. But what is the difference between this case and the case of the cashier? In the book case the last seller saw the paper giving the book dealer authority to purchase. Of course he did not know that the day before a large quantity of books had been purchased; he acted entirely in good faith and the deception was natural. The writer of the letter, however, has done nothing to make the last seller suppose that $5,000 worth of books had not already been bought, nor does the course of business justify the last seller in supposing that the amount authorized might not already have been bought. It may be hard for him to find out the facts, but on the face of the letter it is evident that any one who deals with the book dealer will have to determine the exact situation or rely at his peril on the book dealer's word.

Consider another case. A town treasurer is authorized to borrow a certain sum of money. He secures a certified copy of the vote, goes to one bank and borrows the money, then goes to another bank with the same certified copy of the vote and borrows the money over again. Is the town liable to the second bank? No. On the face of the paper there is but one loan to the town authorized, and any one who lends the money must find out whether or not a loan has already been made.

When we say, therefore, that a principal is bound if his agent has apparent authority, we do not mean that

whenever a third person is deceived into the belief that the agent has authority, the principal is bound. On the contrary, the principal must in some way have been the cause of that deception; he must have caused it by some express representations or by putting his agent in a place where the general course of business is such as to induce the public to believe that the agent has greater powers than he actually possesses. It is much easier to find cases of apparent authority which will bind the principal if the agent is a general agent than if he is a special agent.

Agency by Necessity—The authority of the agent may be enlarged by some particular necessity or sudden emergency, in which case it is the duty of the agent to act for the principal even though he cannot receive advice or directions from his principal. This method of creating the agency relationship is quite rare and one upon which the courts are not all agreed.

Rights of Principal against Agent—The rights which the principal has against the agent may be grouped under the four following headings:

1. A right to have the agent render reasonably diligent and skilful service. The amount of skill which the employer can fairly demand from his agent depends on the character of the contract between the two and on the circumstances which would justify the principal in expecting a greater or lesser degree of skill. When a man employs an expert accountant to act for him, he has a right to expect greater skill than if he were em-

ploying an ordinary bookkeeper. The amount of compensation paid to the employee may also have a bearing on the amount of skill the employer should expect.

2. A right to have the agent act in obedience to instructions and only within the limits of his authority. These limits may be fixed expressly in the contract between principal and agent, or they may be left wholly to implication from the nature of the employment. Perhaps more commonly they are partly fixed by express agreement and partly fixed by natural implication arising from the nature of the employment.

3. A right to demand an accounting from his agent in financial dealings with the agent or in regard to financial dealings of the agent with third persons. It is not enough that the agent correctly expend money entrusted to him; he must furnish a correct account of expenses and of collections.

4. A right to expect fidelity and loyalty from the agent. The agent must inform the principal of such facts that come to his knowledge as would be likely to influence the principal's action. He cannot take advantage of confidential information which comes to him in the course of his agency to make a personal profit at the principal's expense, nor can he accept side compensation of any sort. His compensation as agent must be what is due him directly from the principal under the agreement. For example, if a buyer for a department store is paid a commission by a firm from whom he buys goods, this is side compensation which the buyer as an agent has no right to accept. So strict is the law in this connection that if an agent does accept any com-

mission on the side, the principal has a right to recover it from him. Under such conditions, the principal could also refuse to be bound by the agent's contract, for the third party would be at fault in paying the agent side compensation. Of course, if the principal agrees to side compensation, the agent may accept it. As a matter of fact, when the principal concurs, it ceases to be side compensation and becomes a part of the agent's direct compensation to which he is entitled under his bargain with his principal.

One of the most common violations of the right to fidelity is found where a person undertakes to act as agent for both parties, although often he acts entirely in good faith. This cannot be done unless each party especially agrees that the agent may act for the other party. An attorney at law cannot represent both sides of a case. A real estate or a stock broker cannot represent both buyer and seller. Stock brokers have one practice which perhaps may seem to infringe this rule. A customer comes into a broker's office and says he wants to buy 100 shares of New York Central. About the same time another customer comes in and says he wants to sell 100 shares of New York Central. Must the broker go on the exchange and make a purchase for one customer and then a sale for the other? or may he, so to speak, negotiate through himself a sale between the customer who wants to buy and the one who wants to sell?

What the broker does is this: He buys for himself and sells for himself, but he does so publicly, giving other brokers a chance to buy or sell if they wish. According to the rules of the New York Stock Exchange,

the broker cannot execute this transaction secretly in his office; he must offer the securities in question on the exchange, and the purchase and sale must be recorded on the ticker. If the bidding and asking prices are more than an eighth apart, he may offer the New York Central stock at a price midway between the bidding and asking quotations and buy it himself, charging each customer a commission, but he must actually make the offer or bid aloud on the floor of the exchange. Technically the broker is acting for both parties, but actually he is not fixing the price since he makes an open bid.

Rights of Agent against Principal—What are the rights of the agent against the principal? They are two in number, namely, a right to compensation and a right to reimbursement and indemnity.

1. A right to compensation means a right to the pay that has been agreed upon, or, if no pay was definitely agreed upon but it was understood that there should be some compensation, then a right to reasonable compensation. It is possible to have an agency without compensation. Frequently one man agrees to act for another without pay, and so long as he acts as agent, one who is acting without compensation is bound to the same obligations to his principal as if he were receiving compensation. However, since he is not paid for his services, he may withdraw from his agency whenever he sees fit. Unless the circumstances clearly show that an agency was understood to be without compensation, it would be implied that the agent is to receive reasonable compensation for his services.

2. A right to reimbursement and indemnity. As the agent is acting for the principal, the principal is bound to pay all the bills incurred, no matter what their nature may be, so long as the agent is acting rightfully and within his authority. This obligation of the principal to pay all the bills of the agency means not only that he must pay actual expenses, but that if liabilities of any kind arise by reason of third persons suing the agent or holding him liable, the principal must indemnify the agent against any loss where the action of the agent is within his authority.

Rights of Third Persons against Principal—When do third persons have rights against the principal? In the first place, whenever the agent, acting in accordance with his authority, enters into a transaction with a third person on behalf of his principal, the principal is bound to the third person to just the same extent as if he himself had entered into the transaction. This rule applies not only in cases where express authority is given to the agent, but also where the agent has implied authority to enter into a transaction. If the agent has apparent authority, the principal is bound, for he is estopped to deny his agent's lack of authority. Where the agent has no authority at the time but the principal later ratifies his agent's act, the third party may hold the principal.

Principal Is Liable for Torts of Agent—Not only is the principal liable for the contracts of his agent, but he is also liable for any tort which his agent may com-

mit so long as the agent is acting in the course of his principal's business. Accident cases present the most common form of this sort of liability. A street railway company is liable for accidents caused by its motorman's neglect so long as the motorman is running the car. If the motorman should leave the car temporarily, the street railway company would not be liable for any wrong he might commit while away from his post. The same principle applies to other than accident cases. Suppose that officers of a corporation wrongfully overissue stock. If they are the officers authorized to issue stock and are therefore acting in the general course of their business, the corporation is liable for their tortious act in overissuing stock. If in the execution of an authorized transaction an agent makes an unauthorized and false representation, the principal is liable just as if he personally had made the false statement. Some courts, however, are inclined to absolve the principal from liability for a misstatement in a case where the agent makes the false statement for his own personal benefit.

Undisclosed Principal—The third person may hold the principal liable not only in cases where the agent purports to act for his principal, but also in cases where the agent does not disclose his principal and purports to act as the principal himself, so long as it is true that the agent really is acting in the principal's business. Suppose a selling agent for a manufacturing company enters into a contract for the sale of goods produced in the factory. As selling agents often do, he

contracts in his own name, but he contracts in regard to the sale of the product of the principal, the manufacturer, and on his behalf. Assuming that the contract of the sales agent was authorized, the buyer or third person may sue the manufacturing company although he did not know of the existence of the company at the time he entered into the contract and supposed that he was contracting simply with the agent. As it is phrased in law, an undisclosed principal is liable; and conversely, an undisclosed principal may sue on the contract made by his sales agent. The rule of the undisclosed principal does not apply to contracts under seal made by the agent with the third party.

Rights of Principal against Third Persons—The rights of the principal against third persons follow the same general rule as the rights of third persons against the principal. Generally when a transaction is of such a nature that the third person will have a right of action against the principal if the principal fails to do as he agreed, the principal will have a right of action against the third person if the latter breaks his agreement.

Rights of Third Persons against Agent—Ordinarily the rights of the third person lie against the principal, for the agent merely represents the principal in making a contract. But if an agent contracts for an undisclosed principal, the third person may hold the agent liable as well as the principal. In the case of the sales agent referred to in the paragraph on the undis-

closed principal, the agent was really acting for the manufacturer although he did not say so. Therefore, the third person may sue the manufacturer on the contract, or he may sue the agent. In the latter event, the agent must seek reimbursement from his principal.

Agent Warrants His Authority—An agent is liable in one other case to the third person with whom he deals. If the agent does not have authority to act, the third person can sue him, but the third person cannot sue the principal since the agent has exceeded his authority. In other words, the agent warrants his authority and subjects himself to suit for damages for breach of his warranty.

Termination of Agency by Agreement—The parties may have agreed in their contract that the agency should terminate at a certain time or on the happening of a certain event. The arrival of that time or the happening of the event would naturally end the relationship between them. It would not so operate as between the principal and third parties, however, unless the third parties were informed of the agreement. Performance of the purpose for which the relationship was created terminates the relationship as between principal and agent. Subsequent to the original contract, the parties may make an agreement to terminate the relationship and such an agreement will be good, the abandonment of the rights of each party created by the original contract being sufficient consideration for the promise of each to surrender his own rights.

Termination of Agency by Revocation—Except in the case of an irrevocable agency, which will be discussed later, the principal may at any time revoke the agent's authority as to matters not already executed. Any other rule would enslave the principal to his agent by forcing him, at the agent's will and against his own consent, into contracts with third parties. While the principal has this right of revocation, its exercise may subject him to liability to his agent. If the contract of employment is to terminate at a definite time and the principal without cause revokes the agent's authority before that time arrives, the principal is liable to the agent for breach of contract. If no time is fixed for the termination of the agency, it is an agency at will, and the principal, with or without cause, may revoke it at any time without incurring liability to his agent.

The acts which will amount to a revocation by the principal are various. For example, if an agent has exclusive authority to represent the principal, the appointment of another agent would amount to a revocation. As to making the revocation effective, a revocation operates on the agent from the time he has notice of it. It is effective as to third parties only when those who have dealt with the agent are given notice that the agent's authority is revoked. Without such notice the principal does not escape liability to third persons by reason of further acts on his agent's part. Where an agent is appointed for a particular business, parties dealing with him in that business have a right to rely upon the continuance of his authority until they are in some way informed of its revocation. This notice must be actual to

those who have dealt with the agent and general, as by publication in newspapers, to those who have not before dealt with the agent.

Termination of Agency by Renunciation—The agent may renounce his employment at any time, but if he contracted to serve until a certain time and renounces before that time arrives, he is liable to the principal for breach of contract unless he has ground for renunciation, such as the principal's breach of faith with him. The principal should inform third persons of the agent's renunciation if he would fully protect himself against further acts of the agent.

Termination by Operation of the Law—As in the case of ordinary contracts, a contract of agency may be terminated by operation of the law upon the happening of certain events. The destruction of the subject matter of the agency terminates the relationship if the parties contemplated the continued existence of the subject matter as the foundation for what was to be done. Illness of the agent for an unreasonable space of time would justify the principal in revoking the contract of agency or the agent in renouncing it. Death of the principal brings the relationship to an end. If the agent has no notice of his principal's death and subsequently deals on behalf of his principal with third persons, it is generally held that such contracts do not bind the principal's estate. The death of the agent necessarily ends the relationship. The occurrence of the principal's insanity terminates the relationship, and a judicial find-

ing of insanity is notice to all. Without notice of the insanity, third persons who deal with the agent in good faith are protected. The bankruptcy of the principal terminates the relationship as to all matters affected by the bankruptcy. A change in the law, as the enactment of a statute declaring illegal those agencies that previously had been legal, terminates the relationship.

Irrevocable Agencies—An agency bearing upon a thing in which the agent has an interest, or in which he is subject to an obligation, cannot be terminated by act of the principal alone. The principal cannot terminate the relationship so as to leave the agent under obligations to third persons, thereby shifting his obligations upon the agent; nor can he do so when the agent has an interest in the subject matter of the agency. It is difficult to state concisely what will constitute such an interest that the principal cannot terminate the relationship. It may be said to be some ownership or right in the matter dealt with and not a mere benefit to be obtained from the performance of the contract of agency, such as a commission to be realized from sales. Thus if P sends goods to A, a commission merchant, to sell on commission for him, this agency can be revoked, for A's interest in the money to be realized from the sale of the goods is not such an interest as would make the agency irrevocable. But if A has advanced money to P and is to get back this money from the proceeds of the sale, he has such an interest in the subject matter of the agency, beyond his interest in acting as an agent, that P cannot revoke the agency. Moreover, it would

not be terminated by P's death, insanity, or bankruptcy. The courts carefully examine agencies which are claimed to be irrevocable because coupled with an interest and are inclined to rule against them.

MASTER AND SERVANT

The Nature of the Problems—As we have said, the function of the servant is to perform ministerial or mechanical acts for his master. The chief subject matter of the law of principal and agent deals with contracts, while the chief subject matter of the law of master and servant deals with torts. In performing acts for his master, the servant may inadvertently or wilfully cause injury to a third person or to the property of a third person; or the servant, in performing acts for his master, may be injured by a third person. What is the master's responsibility?

This question must be considered from two standpoints: the relationship of the master and servant as between themselves, and the relationship of the master and servant as to the outside world. For example, the driver of a delivery truck operated by Lord & Taylor negligently runs over a pedestrian. The truck was going at the rate of twenty-five miles an hour, although instructions have been issued by Lord & Taylor to all their servants not to run cars more than fifteen miles an hour in the congested parts of New York City. Is Lord & Taylor liable to the pedestrian? This question involves the relationship of master and servant as to outside parties.

While operating the delivery truck for Lord & Taylor, the same servant is run into by a motor car operated by an irresponsible party. Is the master, Lord & Taylor, responsible to its servant for the injury which he suffers as a result of the collision? This question involves the relationship of master and servant as between themselves. We shall consider this relationship first.

The Relationship of Master and Servant as between Themselves—What is the liability of the master to the servant if the servant is injured while in the performance of his duties? The obligations of the master to the servant at common law may be summed up as follows: (1) to provide a reasonably safe place for the servant to work; (2) to provide reasonably safe, suitable, and sufficient tools and appliances with which the servant may perform his work; (3) to provide reasonably careful and competent fellow workmen and in sufficient number for the work in hand; (4) to warn the servant of any unusual dangers connected with the work; (5) generally so to conduct the work as not to expose the servant to dangers which could be avoided by the exercise of reasonable diligence. Therefore, unless there was a breach of one of these duties by the master, there would be no liability on his part to the servant.

From the servant's standpoint, the common law rules, which have now been modified by statute, were inadequate for several reasons. In case the servant was injured, he had to make out a case that would show that the master had been deficient in the exercise of his

duties. There must have been some kind of negligence by the master, such as furnishing the servant with improper appliances or conducting the work without reasonable care. Risks other than those flowing from the negligence of the master were assumed by the servant. Thus, if the servant who drove the delivery truck for Lord & Taylor had been injured by a third party's carelessness in running into him, at common law there could be no recovery against Lord & Taylor, for it had not been deficient in its duty. Furthermore, even though the injury had happened through the master's negligence, if the servant had also been negligent and thus had contributed to the injury, he could not recover.

The application of these rules inflicted most hardships on the servant in cases where the injury was caused by the negligence of a fellow servant. Thus, if two fellow workmen were working on the twentieth story of a skyscraper being erected by a construction company and, through the carelessness of servant A, servant B was precipitated to the street and injured, there could be no recovery by B against the construction company. The negligence was that of the fellow servant and not of the master, unless it could be shown that the master had known that servant A was incompetent and inclined to be careless and that the master had been remiss in his duty to provide reasonably careful and competent workmen. This latter would be practically impossible to prove, and the result of the fellow servant rule would be to deprive a servant of all right to recover where the injury was due to the carelessness of a fellow employee.

Even if the servant could establish a case against the master, he would have to sue at law and be subjected to the expenses of litigation and its long delays. Ordinarily he would have no money with which to begin this long litigation and would be obliged to retain the services of a lawyer, who would take the case on a contingent fee basis and thus often take from the workman a third, a half, or even a greater portion of the amount that he recovered should the decision finally be in his favor. Perhaps this would be no greater compensation than the lawyer was entitled to because of the labor involved and the prospect of no pay if he lost the case, but regardless of this it was hard on the client.

Workmen's Compensation Acts—The rules of the common law were the outgrowth of conditions surrounding the small shop and involving the use of simple or no machinery. Under modern industrial conditions they have proved wholly inadequate. Accidents will happen in industry, and workmen will be careless not only of themselves but also of other workmen. From the standpoint of society, it has come to be recognized that these inevitable hardships should not be borne by the individual workmen, but that they are just as much a part of the cost of the finished product as the inevitable wear and tear on machinery and should be paid for as such.

With the desire of passing on to the ultimate consumers of the product the cost of such human wear and tear, the workmen's compensation acts were framed. They were developed upon the principle that the cost

of these accidents should be borne in the first instance by the employer who in turn, by increasing the price that he charges for his work, should ultimately pass the added burden on to the community at large. The employer may protect himself against the claims of his workmen by insurance under a plan provided by the state law or, if the state law does not provide for such insurance, by arrangement with private companies. In figuring his total cost for the particular job, he can charge as a part of his operating expense the cost of insurance and include that amount in his charge for the work. By such a method the community ultimately pays for the loss that is suffered by the workmen.

The Character of the Acts—With the exception of a few states, each state and territory of the United States has a workmen's compensation act. The principle underlying these acts is the same throughout the country. The whole theory of the common law was that the master had to be at fault in order that the servant might recover. Under the compensation acts, the old assumption of risk and fellow servant rules are abrogated; it is not necessary to establish any negligence on the part of the employer. Actions under these laws are not prosecuted before the courts but before an administrative board from whose decisions there is only a limited right of appeal to the courts.

The acts seek thus to expedite the recovery and to enlarge the basis for the recovery. Their principle is to grant recovery for *"accidents" "arising out of"* and *"in the course of"* employment. What is an accident? If

a window dresser is decorating a window and swallows a pin, is this an accident? Are occupational diseases accidents? If an old enemy of a janitor shot him while the janitor was at work, would this accident *arise out of* the employment? Suppose a robber had shot the janitor. If a workman were injured while riding to work, would that accident be *in the course of* his employment? Would it make any difference if he had been injured while riding home from work? These are typical of some of the problems that arise.

Referring to the terminology of the acts, the leading Massachusetts case, In re McNicol, 215 Mass. 497, says, "It is not easy to give a comprehensive definition of these words. The injury must both arise 'out of' and also be received 'in the course of' the employment. Neither alone is enough. An injury is received 'in the course of' the employment when it comes while the workman is doing the duty which he is employed to perform. It 'arises out of' the employment when there is a causal connection between the conditions under which the work is required to be performed and the injury."

The Liability of Master and Servant to Outside Parties—Our next question concerns the responsibility of the master for the torts committed by his servant, resulting in injury to third parties. It is, of course, essential that the wrongdoer be the defendant's servant.

The general rule in this connection is that where a tort is committed by a servant while engaged in his master's business and acting in the scope of his employment, the master is liable for such a tort.

However, with the advent of the automobile, many states have varied this common law rule by statute. Today, generally speaking, the owner of a motor vehicle is liable for death or injuries to persons or property resulting from negligence in the operation of the vehicle by any person operating it with the permission, express or implied, of the owner. This liability attaches to the owner unless he can show that the operator of the vehicle had neither express nor implied permission to use or operate the car.

For example, Paul Jones employs John Smith as his chauffeur. Paul Jones never operates his car on Sunday. John Smith, who lives in the town adjoining Paul Jones', is moving and asks if he may borrow his master's car over Sunday to assist in the moving operations, and he is given permission. While using the car for that purpose he negligently runs over some one. Is Paul Jones liable? Under the common law rule, the master would not be liable, because, although the relationship of master and servant exists between Paul Jones and John Smith, the latter was not acting for Paul Jones as a servant at the time he committed the tort. However, under the law as it has been amended by statute in many states, Paul Jones, having given John Smith permission to operate his car, would be liable for the accident.

Except where the law has been changed by statute in tort cases involving motor vehicles, there are two conditions which must exist to make the master liable for the torts of his servant: (1) The servant must be engaged in his master's business, and (2) he must be

acting within the scope of his employment. If the tort is committed by the servant while performing his duty in obedience to the express direction of the master, the master is clearly liable. But the master is also liable for the wrong done by the servant when acting within the implied authority conferred upon him by the master. In other words, if the act can fairly be said to have been committed by the servant in conjunction with the performance of his appointed duties, the master is liable for its consequences.

Independent Contractor—A distinction must be made between one whom we call an independent contractor and a servant. When A desires a particular piece of work done, he has two options as to having it done. He may hire a workman to do it, retaining control of the workman and telling him how he shall do it, or he may let out the work by contract, simply stipulating that it shall be done in accordance with plans and specifications which his architect has drawn up. In the first case, the workman is called a servant; in the second case, he is an independent contractor. The employer retains no control over the contractor or over his method of work; his sole interest here is to have the piece of work turned over to him in its completed state. One who employs an independent contractor is not liable for the negligent acts of the contractor or of the contractor's servants except in two special cases: (1) where the employer personally interferes with the work and by his interference occasions the injury complained of, and (2) where the employer has not used due care in selecting a competent independent contractor.

CHAPTER IX

Partnerships

THE two most common forms of business organization, other than that conducted by a single individual, are the partnership and the corporation. Consequently, it is important to understand the legal effects of conducting business in these ways. Both methods contemplate the association of two or more persons so as to enable them to employ their resources more effectively in carrying on business, but they vary widely in the nature of their association and in the results that flow from their forms of organization.

The Nature of a Partnership—A partnership is essentially an association of two or more persons to carry on, as co-owners, a business for profit. The partnership relation is created by an express or by an implied contract between the parties. Without such an agreement there can be no partnership save in one case, namely, partnership by estoppel, where one represents himself or consents to another's representing him to be a partner when in fact he is not. If a third person relies upon that representation and gives credit to the partnership upon the faith of it, the law permits him to treat as a partner the one who misrepresented his relationship. Thus, if C tells X he is a partner in the firm of A and B and, acting upon that misrepresentation, X sells goods to A and B, X may treat C as being one of the partners of the firm.

Determination of Whether a Partnership Exists—In conducting a particular business enterprise, persons commonly associate in a very informal way, and the question of whether or not they are partners frequently arises. For example, A and B informally go into a business venture. The enterprise fails and A and B owe many debts. A has some property of his own; B has nothing. C is a creditor, all of whose dealings have been with B. If A and B are partners, C may hold A. If they are not partners, C's claim probably will never be worth anything to him. The question of whether or not a certain relationship constitutes a partnership may thus become a most important one. While this question cannot be considered at great length, a few important principles should be recognized.

In order that a partnership relation may be created, there must be an agreement, and that agreement may be express or it may be implied from the conduct of the parties. The agreement must contemplate the transaction of some business in which the parties are to act as principals and of which the parties are to be co-owners. A sharing of net profits, as well as a sharing of losses, is ordinarily contemplated. Indeed, whenever parties have agreed to share the profits of a business, this is strong evidence that they contemplate acting as partners, although mere sharing in the profits does not necessarily determine that they are partners. Thus, a landlord who rents a farm to a tenant on the basis that the tenant shall pay him a certain percentage of the yearly profits does not thereby enter into a partnership relation with his tenant.

The Difference between a Partnership and a Corporation—A comparison of the partnership and the corporation will serve to show some of the fundamental differences between them. Six principal differences may be noted.

1. In theory, a corporation is looked upon legally as a separate entity or person. If A, B, and C form a corporation under the laws of the State of New York, there are four legal persons in existence, namely, A, B, C, and this separate person, or legal entity, the corporation. The law does not, as a rule, consider the partnership as an entity distinct and separate from the members making up the firm, although in a way the business man does look upon the partnership as a separate commercial entity.

2. A partnership may be created by a formal or by a simple contract, oral or written. In fact, it may be created in almost any way as distinguished from the formalities required for the organization of a corporation, which must comply with the corporation laws of the state in which it is formed; namely, a certificate of incorporation must be filed, generally with the secretary of state and with the clerk of the county in which the corporation's principal place of business is located.

3. A partnership may do anything legal which the members decide to do. Since a corporation exists by virtue of a charter granted by the state, the sum total of the powers given in that charter represents the total of all the activities the corporation may undertake. Engagement in activities not authorized by the charter may result in the forfeiture of the charter.

4. The principle of individual liability for the debts of the firm is a fundamental characteristic of partnership law. Each member of the firm is absolutely liable for all the debts of the firm. If a firm consisting of A, B, and C goes into bankruptcy owing $50,000, and B and C are both individually worthless while A has his own private fortune, A will be obliged to pay all of the debts, although, according to the arrangements made by the partners when forming the partnership, they were to share the profits and losses equally. Theoretically, A has the right to contribution from his fellow partners, and should they later acquire property, he would be able to enforce this right. In a corporation, a shareholder is liable only for the value of his share. If he subscribes to a share of stock, par value $100, and pays only $50 on his subscription, the receiver of the corporation in the event of bankruptcy can compel him to pay the balance of his subscription, $50, but that would be the extent of his loss. Statutes may make specific exceptions to this rule. One noteworthy exception is in the case of a shareholder in a national bank, who by statute is liable to an extra assessment* equal to the par value of the stock he owns. In certain states this is true of banking institutions organized under state laws.

5. In a partnership each member is a general agent for the partnership, and his partnership acts bind the firm. In the case of a corporation, a shareholder has no power to bind the corporation by virtue of the fact that he is a shareholder; the position of a shareholder is very similar to that of a voter. The corporation is

*Section 22 of the Banking Act of 1933 abolishes such double liability as to stock issued after June 16, 1933.

run by its board of directors who are elected by the shareholders.

6. Because of one partner's power to create personal liabilities against the other partner, the partnership relation involves a high degree of confidence between the partners. Therefore, by assigning his interest in the partnership to a stranger, one partner cannot give that stranger the right to become a partner in the firm. If a partner dies, his executor is not entitled to become a partner in the firm; instead, a partner's death operates to dissolve the partnership. The situation in the case of a corporation is precisely the opposite. A shareholder may sell his stock at any time, and the new owner immediately becomes a shareholder in the corporation, entitled to exercise all the rights and powers of the old shareholder. The death of a shareholder has no effect upon the life of the corporation. If all of the stockholders of the United States Steel Corporation should die at one time, the corporation would still exist.

Limited Partnership—The situation described in the preceding paragraphs applies to the ordinary partnership. There are also certain special forms of partnership. One of them is the limited partnership, some characteristics of which will be discussed later. In a general way, these limited partnerships represent a combination of the principles underlying ordinary partnerships and corporations. The members may limit their liability to a certain amount, and in that sense the limited partnership is like a corporation. On the other hand, the general principles of partnership apply with

almost as much force to the acts of a limited partnership as to the acts of an ordinary partnership.

Joint Stock Companies—Joint stock companies are large partnerships in which the capital is divided into shares, each partner having his investment represented by a certain number of shares. Like corporate stock, these shares are readily transferable. In the case of large joint stock companies, like the Adams Express Company, the shares are listed on the stock exchange. If a shareholder sells his shares, the buyer succeeds to his rights as a partner in the enterprise. If a shareholder dies, his estate can exercise all the rights on the shares. Thus, like a corporation, death of a shareholder does not operate as a dissolution. Also like a corporation, the shareholders have no direct part in the management of the business, but they do elect the directors to conduct the business. On the other hand, the joint stock company is like a partnership in that all its members or shareholders are individually liable for the debts of the company. If a shareholder sells his shares, he remains liable for debts contracted by the company while he was a shareholder. Again, like a partnership, at common law all the members of a joint stock company had to join in an action by the company, but statutes now provide that actions may be prosecuted by and against the company in its firm name or in the name of its major officials.

The Law Governing Partnerships—In many fields of commercial law, there have been attempts to

codify the laws upon particular subjects and thereby make them uniform throughout the states. These codifications are first drafted by an organization known as the Conference of Commissioners on Uniform State Laws. They are then recommended to the different state legislatures for passage. Many of these acts, known as uniform acts, have been passed by the various states. Among them are the Uniform Partnership Act and the Uniform Limited Partnership Act. In the main, they codify the existing common law and thereby seek to reconcile the variations in the common law as practised by different courts. The Uniform Partnership Act and the Uniform Limited Partnership Act have been adopted by about one-third of the states, and in these states it is to this legislation that one must look in order to determine the law governing partnerships. In the other states the common law as embodied in the decisions of the courts will control.

Who May Be Partners—Since the basis for a partnership is the contract of partnership, contractual capacity determines the capacity of a person to become a partner. At common law, a married woman was incapable of becoming a member of a partnership, but statutes removing the disability of married women have been passed in practically all the states. Generally a married woman today is free to become a partner, except that in many states the law still holds that husband and wife may not become partners. An infant may be a member of a firm on the same general principles that apply to ordinary infant's contracts. His entering the

partnership agreement is not void, but voidable. If, when he becomes of age, he affirms the contract of partnership, he will be liable the same as an adult. However, he has the right to disaffirm his partnership agreement within a reasonable time after becoming of age, and if he does so, he will be absolved from all personal liability for the debts of the firm. It is very generally held that a corporation may not enter into a copartnership with another corporation or with an individual. The reason for this is one of public policy, namely, that in a partnership the corporation would be bound by the acts of persons who are not its duly appointed agents and officers. There may be any number of members in a firm, such matters being left to the choice and wisdom of those operating the business.

Silent Partners—A silent partner is a general partner who takes no active part in the management of the business; he is frequently a secret partner. His liabilities to third persons dealing with the partnership or with the known partners are the same as those of a general partner. As against the other partners, the silent partner has the same rights as if he were a general partner. The difficulty concerning silent partners is the practical difficulty of discovering who they are, not the legal difficulty of holding them liable after they have been discovered.

Delectus Personarum—It is a fundamental principle of the partnership that the partners alone can determine who shall be partners and thereby can prevent

an objectionable person from being forced into the firm. Suppose that A is a member of a firm composed of three persons. He decides to withdraw and tells his two fellow partners that he has transferred all his interests in the firm to John Jones. His two fellow partners believe Jones to be a crook and do not wish to be in partnership with him. They are not obliged to accept him. In other words, the doctrine of *delectus personarum,* or the choice of persons, is strictly applied in partnership because of the very confidential nature of the relationship. Ordinarily the business cannot be conducted satisfactorily unless the partners have the confidence of each other. It is for this reason that, upon the sale of his interest by one partner with the intention of ceasing to be a partner, the law permits the rest of the partners to dissolve the partnership. John Jones, who purchased A's rights in the firm, could not compel the other members to take him in. The firm would have to be wound up, and Jones would simply be able to recover his share of the assets and profits.

Articles of Partnership—We have learned that parties need not expressly declare themselves partners in order to become partners. So the framing of written partnership articles—a written contract of partnership—is not essential, although it is the ordinary and advisable course. A few rules governing the use and construction of such articles where they have been adopted should be noted. The articles should provide for as many contingencies as can be foreseen, such as the nature, name, and place of business, when the relation is

to commence and when it is to terminate, what capital shall be contributed by each, what shall be the share of each in the profits and losses, what shall be the powers of the partners as between themselves, whether the business shall be continued after the death of one or more of the partners, and how the business shall be wound up.

The important thing to note is that if provision be not made, the general law applies, particularly that part governing the powers and duties of partners to each other and to third persons. In other words, the partners may, by their contract, determine what their rights as between themselves shall be, but if they do not so determine their rights, the rules of law will determine them. Thus, they may determine that of two partners one shall have two-thirds and the other one-third of the profits; in the absence of such a clause, the law determines that the profits shall be divided equally. When articles have been once adopted, they may be changed only by the consent of all the partners. This consent need not be formally expressed in words; it may be implied from a long continued course of conduct. The law provides no means to force a partner to live up to his contract except in a very few cases; the most it gives is a right of action for the breach caused by his failure to do as agreed.

Firm Name—The adoption of a firm name is not essential to a partnership, but it is customary and advisable. The names of the partners may be combined, or a single name or a fictitious name or any name used, so long as the rights of other persons are not violated.

In some states the use of the name of a person not a partner is forbidden. The use of the expression "& Company" is also forbidden unless a partner is represented by it. Ordinarily contracts may be made in the firm name and by one partner, but contracts under seal should be made in the names of the partners "doing business as," and so forth, and cannot be made by one partner without authority from the others.

Conveyances of real property should be made to or by the individual partners "doing business as," and so forth, for the law does not generally recognize the firm as a separate person or entity sufficiently to enable it as such to take or give a conveyance. If a deed ran to John Doe & Company, the title to the property would be in John Doe only, although he would be said to hold it in trust for the firm. If the partnership name were given as the grantee, the title would go only to those whose names appear; if the partnership were doing business under a fictitious name, the deed would convey to no one.

Whether land, the title to which is in the name of one partner, is held in trust by him as partnership property is a question of intention, and that question is determined by asking with what money the land was bought, what use it has been put to, whether it has been carried on the books of the firm, with what money the taxes, insurance, and other charges have been paid. If found to have been treated as partnership property, the fact that the title is in one person counts for little, for he will be said to hold it in trust for the firm. The careful business man, however, will avoid trouble by having

the property conveyed to the firm in the proper manner if it is actually partnership property.

The Powers of a Partner—Each partner is an agent of the firm with respect to most matters concerning the partnership business. As such an agent, his acts are binding upon the firm. He has power to do whatever may be necessary to carry on the partnership business in the usual way. In the name of the firm he may sign contracts which will be binding. To be sure, his authority may be limited by the articles of partnership, but such limitation will not be effective as against third parties unless made known to them. Third persons are entitled to regard any partner as a general agent of the firm and to deal with him as such. However, certain acts may be outside the power of a partner because they are not commonly necessary to carry on the partnership business, such as disposing of the good will of the business, confessing a judgment against the partnership, or any act which would make it impossible to carry on the partnership business.

Partnership Property—No single partner owns any single piece of property, but the partnership property belongs to all the partners together. Therefore the property rights of a partner do not include a right to any specific partnership property. He may possess and use any partnership property for partnership purposes, but he is not the owner of it. The property rights of each partner consist of just three things: (1) a right to have his proportionate share of the assets of the partnership

upon its dissolution, (2) a right to his share in the profits of the firm, (3) a right to participate in the management of the firm. He may transfer these rights, with the exception of the third, to any one, but he has no power to transfer title to a specific piece of partnership property except in so far as such an act may come within his authority as a general agent of the firm. Thus if a partner dies, his executor cannot lay claim to any specific partnership property. What the executor acquires is the partner's proportional share in the profits and surplus of the firm's assets. A creditor of an individual partner cannot seize or attach or levy on firm property, because no part of that firm property belongs to his debtor. The creditor must file a bill asking that the court determine the partner's share and that so much as is found due to the debtor partner be applied to discharge that partner's indebtedness.

Relation of Partners to One Another—The relationship between partners and the reciprocal rights and duties owed by them are governed by the general conception that the partnership is a cooperative undertaking. These rights and duties may be specifically provided for in the partnership agreement, but in the absence of specific provisions the duties of the partners are governed by law. Indeed, it is rare for any agreement, no matter how carefully drawn, to cover all their obligations to each other, so that every agreement must be supplemented by those rules of law which govern the partners' relationship. Thus, in the absence of a specific agreement on these matters, the common law

provides that the partners share equally in the firm's profits and surplus and contribute equally to whatever losses are incurred.

If one partner is compelled to pay more than his just share of these losses, he is entitled to contribution from the other partners with respect to the excess that he paid over his own share of the loss. A partner is not entitled to any remuneration for managing the business of the firm. His position as partner carries with it the duty of management, and he receives his remuneration by having his share in the profits of the partnership. The relationship between partners is a fiduciary one. They must make full disclosure to each other of all matters that concern the partnership business. Being agents of the firm, they cannot accept any side compensation for the transaction of partnership business, but they must hold all such profits for the benefit of the firm.

One important right of a partner is his right to an accounting. Not only may a partner at all times have access to the partnership books and inspect them, but he may claim an accounting upon dissolution of the firm so as to determine his interest in the firm. He may also claim an accounting without a dissolution of the firm where one partner has made secret profits, or where he is denied access to the books, or under any circumstances that would make his claim for an accounting just and reasonable.

Powers of a Majority of Partners—As we have said, partners have equal rights in the management of the business from the mere fact that they are partners,

and they possess equal rights irrespective of the share that each partner has in the business. If the partners disagree as to the way in which the business of the firm is to be managed, then a majority of them have power to decide what shall be done. But there are limits even to the power of a majority. They can only carry on the business of the firm; any vote or action of the majority to change the character of the business for which the firm was organized or to make any fundamental change in the original articles of partnership would be invalid.

Rights of Third Persons against Partners—On page 180 we stated that the acts of a partner within the scope of the partnership business bind the firm. When we speak of the firm, we must remember that the law regards the partners as the firm. Therefore, their liability on any contract is a joint liability. If A, B, and C are partners and the partnership is indebted to X for a certain sum, X must sue all the partners together. Of course, he may collect his judgment from any one of them—A, for instance. A in turn can compel B and C to contribute their share of the partnership debt, but A cannot compel X to collect a third of the debt from each partner. Since the liability of the partners is joint, all the common law rules governing joint obligations will apply, except where they have been modified by statute. The liability of the partners for a wrong done by one partner within the scope of the partnership business is joint and several, and the rules applicable to joint and several obligations will control the enforcement of this liability. Where a person becomes a part-

ner by estoppel, his liability to those who in good faith acted upon his misrepresentation is similar to that of the ordinary partner.

Dissolution of Partnership—A point of time occurs when the partnership ceases to carry on business; this is known as dissolution. The partnership affairs must then be wound up; this is the second step. Finally, the partnership assets must be distributed to creditors and partners. When these three things have happened, the partnership is truly at an end. Dissolution may be effected either by act of the partners or by law. Under the first alternative would come such things as the accomplishment of the object for which the partnership was formed, the termination of the time during which the partnership was to exist, or mutual consent of all the parties concerned. Dissolution by operation of law would operate in such cases as the death of a partner, the bankruptcy of a partner, or dissolution by a court where it is absolutely certain, in the opinion of the court, that the business cannot be successfully continued longer because one partner is insane or incapacitated or persistently breaks the partnership agreement. Although some of the partners may not wish to wind up the affairs of the business, the court may order it done in the interest of all concerned.

Winding Up—Upon dissolution, the authority of any partner to act for the partnership is at an end except so far as may be necessary to complete transactions begun before the dissolution took place. If a part-

nership is dissolved by death, for instance, the surviving partners have a right to liquidate the business; they may carry on existing contracts and dispose of the stock on hand to the best advantage. If incidental purchases of new goods are required to complete existing contracts, they may be made, but in general new business cannot be undertaken.

After its dissolution, if a partner purports to act for the partnership beyond his right of merely winding up the business, serious difficulties occur. Of course the partner will in that event be individually liable to the third person upon any contract he may make. But will the partnership be bound? This depends upon whether the third person had notice of the dissolution. If the dissolution was by a court decree or because of the bankruptcy of a partner, the court proceedings serve as notice of the dissolution to all the world and thus the partnership would not be bound. If the dissolution were caused by some circumstances of which the third person would have no notice, such as death of a partner or the mutual consent of all the partners, the partnership would be bound provided the other party had known of the partnership but not of its dissolution. The Uniform Partnership Act, however, provides a simple way by which the partnership can avoid such liability, namely, by advertising the fact of the dissolution in a newspaper of general circulation in the place or places at which the partnership business was regularly carried on. This rule follows the general principle of agency that a revocation must be communicated to the third party in order to be effective.

Division of Assets—Upon final liquidation the question of division of assets arises. The creditors of the partnership are paid first. Partners who have made advances to the partnership and are thus actually creditors of the partnership are paid next. Each partner is then entitled to the return of as much money as he contributed to the partnership. Any balance then remaining is distributed as profits according to the terms of the partnership agreement, and the same ratio is used for partnership contributions where losses must be made up. In the absence of an agreement covering these points, assets or losses are divided equally among the partners.

Limited Partnerships—The object of a limited partnership is to enable one or more partners to avoid unlimited liability for debts. In a general partnership the partners are each liable, individually, for the full amount of the firm's indebtedness. If one partner is compelled to pay more than his share, he may seek redress by demanding contribution from his fellow partners; but if they are not solvent, he will not be able to secure reimbursement. For instance, if there are three partners, two of whom are insolvent, the solvent partner will have to pay the debts of the firm and will have no redress except such as he may be able to get from the insolvent estates of his two partners. In a limited partnership, however, a limited partner does not stand to lose any more than the actual amount of money he puts into the firm.

The formation of a limited partnership depends en-

tirely upon statutes, which originally varied a great deal in the different states. Now about one-third of the states have adopted the Uniform Limited Partnership Act, bringing some uniformity into the general rules of law governing limited partnerships. Such partnerships may now be formed by two or more persons, one or more of whom shall be general partners and the others limited partners. Like ordinary partnerships they are formed by agreement, but the agreement setting forth all the facts must be filed in the form of a certificate with the clerk of the county where the business is situated and must be published, so that the public may be informed of the circumstances and credit to the firm may not be given by the world at large on the assumption that a limited partner is a general partner.

Character of the Limited or Special Partner— The limited partner puts a specified amount of money into the firm. That money may be reached by creditors of the firm, but they cannot hold him further liable. The general partners of a limited partnership are agents for the partnership in the transaction of its business and have authority to do whatever is necessary to carry on such business in the ordinary manner. They are liable to creditors of the partnership the same as any general partner in an ordinary partnership. The limited partner, however, is liable for the obligations of the partnership only to the amount of capital invested by him in the partnership. Because of this restricted liability, his rights are also less than those of the general partner. He has no right to participate in the man-

agement of the business or to control the firm's operation. However, he may inspect the partnership books and obtain an accounting when circumstances render it just and reasonable, for as an investor he is entitled to information which will enable him to check the character of his investment. If the limited partner exceeds his rights and actively participates in the management of the business, he then loses the benefit of his limited liability and becomes liable to creditors of the firm as any general partner.

Limited—We often find the abbreviation "Ltd." affixed to the name of a company. This does not mean a limited partnership. The word limited is used frequently in connection with the names of English or Canadian companies organized under the English or Canadian statutes, but such companies are analogous to corporations rather than to limited partnerships. Their liability is limited entirely to the assets in the company's hands. The liability of all stockholders is limited. There are no general partners; the English and Canadian laws require the word limited to be added to the company name merely that the public may not be deceived into believing that the company is a partnership.

CHAPTER X

Corporations

A CORPORATION is a fictitious person created by the state. If A, B, and C, as incorporators and sole stockholders, organize the X corporation, there are four persons, A, B, C, and the X corporation. The fact that the corporation itself is a person, possessed of such powers as the state, its creator, may endow it, is very important. Being a person, the corporation owns its property instead of its property being owned by its stockholders or officers. Conveyances of property to and by it must be made in the name of the corporation and not in the names of its stockholders. All suits must be brought against or by the corporation as an entity and not against or by any of its individual stockholders.

Kinds of Corporations—Corporations may be classed as public, quasi-public, and private. Private corporations are those created for private enterprises, such as manufacturing, banking, and trading corporations. Religious and charitable corporations are also included in this classification. Public corporations are those created for the purpose of government, such as cities, towns, villages, and institutions founded by the state and managed by it for governmental purposes. Quasi-public corporations are those engaged in private business which is affected with a public interest, such as railroads, gas companies, water companies, lighting

companies, and the like. It is the private corporation with which we are most concerned in commercial law; hence this chapter will be devoted largely to a discussion of that class.

The Creation of a Corporation—A corporation must be created by legislative authority. Formerly, a corporation was created by a special act of the legislature, but in recent years it has become the universal practice for a state legislature to pass a general corporation act, under which any group of persons of the requisite number may become incorporated by complying with the provisions of the act. The formation of corporations under the laws of most states is a simple process, requiring in general the preparation of an official document termed the certificate of incorporation or the charter, which sets forth the facts as required under the laws of the state wherein the corporation is to be organized.

While not uniform, these laws generally require the following information: the name to be used by the corporation, the names of the proposed directors and incorporators, the general purposes or objects of the corporation, the location of its principal office and place of business, how long it is to last, the amount of its authorized capital, the par value of its stock, and a statement in regard to any preferred stock which may be contemplated. Other details are sometimes required under the various state laws.

This official document must generally be signed or executed by those persons who are the incorporators

of the corporation. As a rule, three or more incorporators are required, although in some states five is the minimum. After the official document has been duly executed, it is usually required to be filed in the office of the secretary of state. Generally a copy must also be filed in the office of the county clerk of the county wherein the principal office of the corporation is to be located. This procedure, however, is subject to some variations, and the statutes of the state involved must always be closely followed.

As soon as the official document has been properly filed and the other necessary steps have been taken, the incorporators hold the first meeting and effect an organization; after this meeting the corporation is generally in a position to transact business, although some state laws provide in effect that corporations shall not commence business until a certain portion of the capital has been paid into the corporation in cash.

Powers of Corporations—A corporation is not authorized to do anything beyond the powers granted to it by law. As to the powers possessed by a corporation, they may conveniently be divided into those which are express and those which are implied. In the charter or certificate of incorporation, there is usually a statement of the general purposes or objects for which the corporation is formed, that is, the general business in which it is to engage. There is also a statement of the general powers of the corporation, which, because they are mentioned specifically in the charter, are called the express powers of the corporation. Needless to say,

however, it is not usual nor is it possible to attempt to indicate in the official document all the details of the operations of the business. Therefore, it is necessary to imply that, in addition to the express powers, the corporation has power to do such acts as may be reasonably necessary or incidental to the carrying on of the business mentioned. Powers of this nature are termed implied powers.

The total powers of a corporation, then, consist of the express powers and those additional powers which are reasonably necessary and incidental to the carrying out of the express powers. No powers can be implied to give the corporation authority to do acts which are not reasonably necessary and incidental to the conduct of its regular business. If any other powers were implied, the corporation would in reality be engaging in outside business, which, under its charter, it has no power to engage in.

Let us assume that the X company is incorporated to build, run, and operate a railroad between two towns, A and B. The official charter of the corporation may state further details of the corporation's powers or it may not. If further details are not stated, the corporation obviously would expressly have the power to build the road and to operate it between the towns mentioned. It would have the implied power to do any act reasonably necessary or incidental to the operation of a railroad, such as to purchase rails, ties, or other railroad supplies, to hire employees, to erect stations, to give negotiable paper in payment for its supplies, and to raise the money necessary to carry on its business by mort-

gaging its property or otherwise. In other words, the corporation may be said to have as implied powers all those which an individual would reasonably and usually exercise if he were operating the railroad. However, the corporation would have no power, express or implied, to purchase a stock farm, or ordinarily to operate a steamer line or a grocery store, or to lease its line, for these acts would not be reasonably necessary to the railroad business.

Ultra Vires Acts—When a corporation attempts to do an act which is clearly beyond its express or implied powers, such an act is generally termed ultra vires. It may frequently consist of an attempted contract, hence we must consider with some care contracts of corporations which may be termed ultra vires. There are several views held by the courts concerning the effect of ultra vires. One rule, known as the federal rule because it is followed by the federal courts although it also prevails in some states, is that the corporation which lacks authority to enter into ultra vires contracts has no capacity to make them. Therefore any such contract is void, and no action can be brought upon it. But if the corporation has received any benefits for which it has not paid, it can be held liable for these benefits upon a quasi-contractual duty to pay their reasonable value.

A second view held in many states differentiates between various contracts. If the contract is wholly executory, that is, if neither party has parted with anything in pursuance of it, no action can be brought upon it by either party. If, on the other hand, the contract has

been so acted upon that it would be inequitable for either party to set up the defense of ultra vires, the courts may refuse to entertain the defense.

A third view that is commonly held also differentiates between various contracts but on another basis. It is often very difficult to tell whether a particular contract is ultra vires. To an outsider it may very well appear as incidental to the corporate business and therefore within the corporate powers; consequently, he may have no reason whatever to suspect or doubt the particular corporation's power. If the outsider does in fact reasonably rely upon the corporate power to make such a contract, he may generally enforce the contract against the corporation on the ground that, having been deceived by appearances and having had no warning that the corporation actually lacked power, he has paid over money or delivered goods or performed services or parted with other value under the contract. This enforcement is permitted under the principle of estoppel; that is, the corporation is estopped or forbidden to evade its obligation by asserting that it had no power to make such a contract.

The entire doctrine of ultra vires has been left by the courts in much confusion. For this reason, in a few states statutes have dealt with the matter. The Ohio Corporation Law satisfactorily disposes of the problem by providing that the defense of ultra vires shall not be available to either party to a contract unless the outsider actually knew that the contract was beyond the corporate powers, and by providing further that the directors or officers of the corporation shall be liable to

the stockholders for any ultra vires action which results in loss to the corporation.

Ultra Vires Conveyances of Property—A corporation may not possess the power to acquire certain kinds of property, or there may be a limitation as to the amount of property it may hold. In such an event, what is the effect of an attempt by it to acquire property? Suppose that a corporation's charter authorizes it to hold real property only to the value of $1,000,000, but that after acquiring this much property, the corporation obtains a deed of additional property. The acquisition of this additional property is clearly an ultra vires act. Nevertheless, having acquired the title to the property, the corporation may exercise the ordinary rights of ownership over it, convey it to some one else, use it, or maintain ejectment against any one trying to dispossess the corporation of the property. However, where the property is conveyed to the corporation by will, which very often happens with charitable corporations, the gift of this property may be set aside by the relatives of the deceased person.

Liability for Torts and Crimes—Closely allied to the problem of ultra vires transactions is the question of the corporation's liability for the wrongs it may commit. Ordinarily the corporation is liable, the same as an individual, for all torts committed by its agents while acting within the scope of their authority. A corporation is also liable for torts committed by its agents in the conduct of an ultra vires enterprise, although

some courts refuse to recognize such liability unless the enterprise was authorized by the corporation.

A corporation may also be held liable for crimes. The punishment inflicted on the corporation can be only a fine; the corporation cannot be imprisoned, although in exceptional cases the directors may be. It seems, however, that there are certain crimes which a corporation cannot commit because they involve the possession of a particular mental attitude by the offender, and the corporation, apart from its agents, cannot possess any mental intent. Such a crime would be first degree murder, which requires the possession of malice aforethought. An agent of a corporation could commit murder, it is true, but this is not the same as the commission of murder by the corporation.

Power of the State over Corporations—One control over ultra vires actions is afforded by the power of the state over corporations. Since the state creates the corporation, it has a certain control over it. Thus the state may bring an action to forfeit the charter of a corporation if it engages in ultra vires transactions. This is known as a "quo warranto" proceeding. It is rarely used, however, unless the ultra vires activity of the corporation is unusually flagrant and threatens to injure other interests which the state itself desires to protect.

The state also possesses a visitorial power over corporations, or the power to visit a corporation and examine into its manner of conducting business and its observance of the laws. The visitation of national

banks by the Comptroller of the Currency is a common example of the exercise of this authority. The power of visitation is not commonly exercised over private business corporations because the stockholders can generally be depended upon to look after their own interests. It is more frequently employed to examine into the conduct of charitable corporations in order to insure their efficient management.

The state possesses the power to change the corporate character. Originally this was not true, for the charter was regarded as a contract. The case usually cited in illustration of this old rule is the famous Dartmouth College case, in which the Supreme Court of the United States handed down a decision that a law purporting to alter the corporate charter was void as impairing the obligation of a contract in defiance of the United States Constitution. Since that decision, however, the states have passed laws by which they reserve to themselves in all cases the power to alter, amend, or repeal the charter of any corporation thereafter organized. As practically all the corporations of today have been organized since the passage of such legislation, their charters are subject to this reserved power of the state to alter, amend, or repeal them.

Anti-Trust Acts—An important control over general business, including corporate activity, is found in anti-trust legislation. The legislation of Congress, known as the Sherman and the Clayton Anti-Trust Acts, applies only to enterprises engaged in interstate commerce. But many states have similar laws applicable to enter-

prises whose activities are confined to one state alone. These laws aim at monopolies and combinations in restraint of trade. It is impossible here to enter into a discussion of what constitutes a monopoly or an unreasonable restraint of trade, but agreements to raise prices or to limit production or to exclude competition are examples of such unlawful conduct. The Federal Trade Commission is concerned with the enforcement of the anti-trust acts, but it also has the wider power of suppressing unfair competition in business. It investigates unfair practices, such as restrictions on resale prices, tying clauses, misleading advertising, and the like, and orders businesses, including corporations, following such practices to discontinue them.

Foreign Corporations—A foreign corporation is one which is organized under the laws of some foreign country or under the laws of some state other than the one in which it is doing business. A corporation formed under the laws of a foreign country is more frequently referred to as an alien corporation. For example, a company organized in New Jersey may enter the State of New York and do business. However, if a New Jersey corporation comes to New York and makes a regular practice of doing business, it must comply with the provisions of the corporation law of the State of New York and secure a license to do business in New York. It is not uncommon to enforce this provision by providing that if a foreign corporation does not take out this license, it shall not be allowed to sue in the courts of the state where it is doing business.

Promoters—A promoter is a person who brings about the organization of a corporation, gets together the people who are interested in the enterprise, aids in procuring subscriptions, and takes general charge of all the matters incident to the formation of the corporation. Before the corporation is actually organized, the promoter commonly enters into contracts for the conveyance of property to be ultimately turned over to the corporation. He also performs valuable services in the organization of the corporation for which he expects compensation from the corporation. The legal characteristics of his services and his contracts require analysis.

Obviously the corporation is nothing before it is formed, and until it is formed it cannot make a contract nor appoint an agent. Therefore, in order to impose upon a corporation the liability to pay a promoter for services rendered to the corporation before it was formed, some valid contract, supported by valid consideration, between the promoter and the corporation after it has been organized must be shown. Again, where a promoter contracts ostensibly with a third party for the conveyance of property to the corporation that is to be organized, no liability upon this contract will automatically attach to the corporation when it is formed. The corporation cannot be liable for the acts of a promoter before the corporation came into existence. However, after coming into existence, it may adopt the acts of the promoter and thereby render itself liable. If, knowing the terms of an agreement made by a promoter, the corporation takes advantage of the agreement or rec-

ognizes it, the corporation becomes in effect a party to the agreement.

The promoter stands in a fiduciary relationship to the corporation, and he cannot make any secret profits at the expense of the corporation. If he has secured property for $1,000,000, he cannot turn it over to the corporation for $1,500,000 and pocket the profit for himself. In contracting with the corporation the promoter is under a duty to make a full and complete disclosure of everything he knows about the subject of the transaction; if he fails to make such a disclosure, the corporation may avoid the contract.

Stock Subscriptions—Before a corporation is organized, it is customary to secure subscriptions to its capital stock so as to provide it with the necessary working capital. These subscriptions are not of themselves binding contracts with the corporation, for the corporation has not yet come into existence. Instead, the subscriptions are really offers to take stock when the corporation comes into existence. The acceptance of these offers, which turns them into binding contracts, takes place when the corporation is organized and the stock is allotted to the various subscribers. Prior to that time a stock subscription, like any offer prior to acceptance, may be revoked.

Issue of Stock—In theory, the stock of a corporation is issued for an amount of money or of property equal to the par value of the stock. Statutes commonly provide that no stock shall be issued save for money or

for property received to the full nominal value of the stock. The purpose of such a provision is to enable creditors to rely upon the fact that the corporation originally had in its hands assets equivalent to the par value of the stock issued. If the stock is issued for less than the par value, the stockholders may be required to contribute the unpaid balances on their stock in the event that the corporation does not have sufficient assets to satisfy its creditors. The requirement that the stock subscribers invest at least the nominal value of the stock is thus a condition precedent to their privilege of limited liability.

Stock is often issued for property received by the corporation as well as for money. For example, promoters are commonly paid in this fashion for property conveyed by them to the corporation. In many states there is no limitation on the valuation which may be placed on the property or rights transferred to the corporation, provided it is not a fraudulent and a purely fictitious valuation. If the property is treated by the parties as having a value equal to the nominal value of the stock issued for it, the stock will be regarded as fully paid up, however little the property may actually be worth. Some states, however, insist that the property shall be reasonably worth the par value of the stock. In still other states, an official must approve the valuation put upon property transferred as payment for stock, and in such states it may be assumed that the assets of a corporation represent at least approximately the amount of its capital stock.

Where no par value stock is issued, these require-

ments are not applicable. Such stock carries no guaranty on its face that a certain amount of property or money has been transferred to the corporation for shares of stock. Its issuance is a red flag to creditors that they cannot rely upon any dollar sign appearing on the stock certificates.

Kinds of Stock—Common stock is the ordinary type of stock. It represents that the owner is entitled to a certain share of the assets of the corporation and that he is entitled to a certain share of the profits after all prior claims have been paid. Common stock may be issued with or without voting powers. It may be issued with a par value or with no par value.

Preferred stock, like common stock, also represents that its owner is entitled to a certain share of the assets of the corporation and to a certain share of the profits after prior claims have been paid. It differs from common stock in that it entitles the owner to a preference as to the distribution of profits in the form of dividends and usually upon liquidation as to assets. After payment of the preferred dividend up to a specified amount, the common stockholder is entitled to all additional distribution unless the preferred has a participating feature. Such a feature usually entitles the holder to share with the common according to a specified ratio after the common has received a stipulated dividend.

Preferred stock may be guaranteed, which ordinarily means that the specified dividends will be paid if they are earned and not that the payment of the specified dividends is guaranteed.

Preferred stock may be cumulative or non-cumulative. It sometimes happens that a corporation does not have sufficient earnings in a particular year to pay dividends. In such an event, is the holder of 7% preferred stock in a position to demand that the dividend which was passed be paid the following year? Suppose the corporation earns nothing in 1931 but earns 14% in 1932. The holder of one share of a non-cumulative preferred stock would receive only the usual 7% dividend in 1932. If the stock were cumulative, he would receive 14%. In other words, on cumulative preferred stock the unearned dividends accumulate and become a charge which the corporation must pay, when sufficient is earned in prosperous years, before the holders of common stock are entitled to receive any dividends. Usually the stock certificate and the articles of incorporation specify whether stock is cumulative or non-cumulative. If they do not, then reference to the law of the state where the company is incorporated is necessary to decide such a question.

Treasury Stock—Treasury stock is stock which was originally issued by the corporation for value but which has been re-acquired by the corporation, either by gift or by purchase, for the purpose of allowing the corporation to sell it at its market value and thus obtain additional working capital. If the stock was originally fully paid up, the corporation may dispose of it again below par, in which case the purchaser will not be liable to make up its par value, as he would be if the stock were originally issued for less than its par value.

Bonds—Bonds differ from stock in that they are direct obligations of the corporation to repay a certain sum of money at a certain date and to pay interest on that sum at stated intervals. This interest must be paid no matter what the earnings of the corporation are. The nature of a corporate bond can best be explained by reference to a real estate bond and mortgage. When money is loaned on real estate, the mortgagor, or the one who borrows, executes two papers in favor of the mortgagee, or the lender. The first paper is either a promissory note or a bond. The second paper given as security for the note or bond is a mortgage, which conveys the title to the property to the lender, with the provision that if the borrower satisfies the conditions imposed in the bond—that is, the payment of a certain sum of money at a given time, together with interest as agreed—the conveyance, or mortgage, is to be held null and void.

What Is a Corporate Indenture?—In corporate bond issues the indenture takes the place of the mortgage. It contains within it a mortgage whereby the property is conveyed or deeded to the mortgagee, with the provision that the deed so given is to be held null and void in the event that the conditions named in the bond are faithfully carried out. But the indenture is broader than the mortgage; it contains provisions other than those bearing directly on the mortgage. A consideration of the nature of corporate borrowing will reveal the necessity for such additional provisions.

It is always possible for an individual of moderate

means to obtain a loan secured by a lien on his property, provided the security is considered good and ample. If his property is of such great value that a loan of several millions of dollars is desired, it would be difficult, or even impossible, to find any one person willing to lend so large an amount. However, if the borrower could find a number of persons who could and would jointly contribute enough money to equal the amount of the loan, he could divide this total amount into equal parts, and each lender could have such a proportionate interest as might be desired. This is the case with large corporations. Owing to the fact that the holders of the bonds have only a fractional interest in the loan and therefore in any property that may be pledged to secure it, it is impossible to create separate mortgages in favor of the individual bondholders on any particular part of the property.

The interests of the bondholders are in common. For this reason and others, corporations are obliged to create what is known as a mortgage deed of trust, making a mortgage, to secure the many bonds, in favor of some responsible individual or trust company, who holds it on behalf of the various bondholders in accordance with the definite terms of the trust. The holder is therefore known as the trustee.

In addition to covering the mortgage, the indenture of the corporation must contain other related and necessary covenants, especially those having to do with the trust that must be created. A vast amount of detailed work underlies the drawing of the indenture. Some of the features to be considered are the authority of the

corporation to borrow money and pledge property, whether the amount it seeks to borrow is in excess of the statutory powers of the corporation, whether the purpose for which the money is being borrowed is in accord with the charter of the corporation, the authority of the officers to issue bonds, the amount of the bonds authorized, their title, denomination, and form, the dates of issue and maturity, the rate of interest and where payable, and so forth. Consequently, before the investment banker underwrites the issue of bonds or makes his purchase from the corporation, there is always a painstaking and minute investigation of the new security, from many different viewpoints, made by and on behalf of the banker.

Of course there are various kinds of specifically secured loans in addition to the example given above. However, in contradistinction to such loans are the entirely unsecured obligations which in the United States are ordinarily called "debentures." The holder of a debenture cannot bring foreclosure proceedings, for in the absence of specific lien security or a trust agreement he is merely a preferred creditor. However, as a creditor he may resort to proceedings under the contract, either to have a receiver appointed or to obtain a judgment and levy execution.

By-Laws—The power to make the by-laws of a corporation is vested in the stockholders. The purpose of the by-laws, which are adopted at the organization meeting, is to regulate and define the duties of the stockholders toward the corporation and toward each other,

as well as to provide for the general government of the corporation. There are certain qualifications which all by-laws must possess. They must be reasonable and not inconsistent with law or with any rule of public policy. It would not be possible for a majority of the stockholders at a regular stockholders' meeting to pass by-laws which would deliberately deprive the minority stockholders of rights which belong to them. The by-laws are always subject to the provisions of the corporate charter. Consequently, a corporation which is authorized to operate a railroad cannot change the nature of its business simply by passing a by-law to the effect that it is deemed wise to enter into the steel manufacturing business.

Stockholders' Meeting—In order that the acts of the majority of stockholders shall be valid, they must be authorized at a regular stockholders' meeting, which must be held in the principal office of the company after due notice, as required by the by-laws, has been given to all the stockholders. Of course, in a large corporation with a hundred thousand shareholders, like the United States Steel Corporation and the Pennsylvania Railroad, very few of the stockholders actually attend the meetings. The directors usually send out with the notice of the meeting a form of proxy, and the stockholders who are not able to be present send in their proxies authorizing certain persons to vote for them. In this way, a majority of the stockholders are present at the meeting, either in person or by proxy.

A proxy is merely a power of attorney or agency by

means of which a stockholder authorizes another person to vote his shares of stock in his place at a corporate meeting. A proxy should be in writing and in the form required by the statutes of the particular state. It is often, but not necessarily, under seal. A stockholder who has given a proxy may revoke it whenever he chooses, and the revocation will serve to prevent the holder of the proxy from voting on it. It makes no difference whether the person revoking the proxy violates his contract with the person to whom the proxy was given. That contract is only a private matter.

Management of Corporations—The management of any corporation rests directly with the board of directors, and they may be considered as agents of the corporation to direct its business affairs. However, in their action the directors are subject to any limitation upon their power which may have been included in the charter or certificate of incorporation or which may have been adopted in the by-laws.

The directors are also subject to any provisions in the statutes of the state relating to their powers. The statutes frequently provide that directors shall not take certain important actions without special procedure involving a meeting and vote of the stockholders. Such matters include amendment of the corporate charter (thereby changing the purposes of the corporation), change in the name of the corporation, increase or decrease of authorized capital stock, sale of the total corporate assets and franchise, consolidation of the corporation where permitted by statute, and the giving of

mortgages upon the corporate property. This last point is especially important since the validity of a corporate mortgage as security for a loan of money depends upon whether the mortgage was authorized and was given in all respects pursuant to the statute of the state involved.

Where the directors' authority is not limited by the statutes or the charter or by-laws, they may be considered as having full power to manage the affairs of the corporation. They may elect a president and other corporate officers and may appoint any other agents or employees at their discretion. They may also define the powers to be exercised by the president and the other officers and employees. Although they have the power to limit the authority of the president or any other officer, yet where a person deals with the president or any other officer of a corporation acting in behalf of the corporation, he may reasonably rely upon the fact that the president or other officer has powers similar to those generally possessed by such an officer. Thus the corporation might be bound by the acts of an officer even though he violated some limits placed upon him by the directors.

Assume that the X Company is in the business of manufacturing furniture and that A, the president, makes a contract with B, an outsider, for the purchase from the latter of certain wood to be used in the corporate business. As a matter of fact, A has no power to make such a contract, since the directors have passed a resolution forbidding him to purchase any raw materials without first having the proposed purchase

approved by the board of directors. However, since B has not in any way been warned of this limitation upon A's power, and since a contract for the purchase of materials would be a usual one for the president or executive head of such a corporation to make, B may reasonably assume that A has power to make the contract. Therefore, B can hold the corporation to the contract under the principle of apparent authority which we considered in connection with the law of agency. The directors, in turn, have a claim against the president for any loss sustained, for not only has he violated his duty but he has also disobeyed and disregarded explicit instructions.

Election of Directors—The directors of a corporation are elected by the stockholders, generally at the regular annual meeting. The statutes of many states provide that at least a certain proportion of the total number of directors shall be elected annually. The method of electing the directors is usually provided for by the statutes of the various states. It is commonly the rule that each stockholder shall have one vote for each share of stock owned by him, although in some states what is termed "cumulative voting" is allowed. This method of voting generally permits each stockholder to have as many votes as he owns shares of stock multiplied by the number of directors to be elected at the meeting, and he may cast all of his votes for one candidate or split them among the candidates in any manner he wishes. In other words, if five directors are to be elected, a stockholder may concentrate all his

votes upon one or upon two or three of the candidates, but he is not compelled to vote for each one.

Cumulative voting is authorized for the purpose of permitting the minority stockholders to concentrate their votes upon one or two of the candidates and thus have some representation upon the board of directors. Assume that the X Company has an authorized capital stock of $100,000, composed of 1,000 shares at the par value of $100 per share. Assume further that six individuals, each owning 100 shares of stock, act in unison thereby constituting a majority, the other 400 shares of stock representing the minority stockholders. A stockholder would usually have one vote for each share of stock owned by him. Therefore, if five directors were to be elected under the usual method of voting, those individuals composing the majority of the stockholders would succeed in casting a majority of votes for each of the five directors and thus elect their own candidates. This would leave the minority without representation on the board. However, if cumulative voting were used, the minority, having a total of 2,000 votes (400 multiplied by five, the number of directors to be elected), could concentrate 2,000 votes upon one or two, elect their candidates, and thus obtain representation on the board. In directors' meetings, each director has one vote, no matter what amount of stock he may own in the corporation. The directors, in their meetings, may not vote by proxy.

Voting Trusts—The proxy principle is involved in what are termed voting trusts. A voting trust is an

arrangement whereby a number of stockholders may place their stock in the hands of certain persons and give these persons the right to vote on the stock. In other words, it is a concentration of the stock of a number of persons in the hands of one or a few persons, who are termed voting trustees. The statutes of the various states with regard to the legality of voting trusts should be consulted. As a rule they are permitted, with the restrictions that the agreement under which the stock is deposited with the voting trustee or trustees must be in writing and that any stockholder may have the right to deposit his stock with such trustee or trustees and become a party to the voting trust. The statutes also frequently limit the time during which such a voting trust may continue.

Liability of Directors—Whether a corporation becomes liable by virtue of action taken by its officers or directors depends upon the principles of agency as applied to the law of corporations. These principles have already been stated. Whether the directors or officers are personally liable is of course another matter. Conceivably they may be liable to their employer, the corporation, or they may be liable to creditors of the corporation.

Liability of Directors to the Corporation—Directors are not directly liable to the shareholders as such. Any injury or wrong they may do the shareholders is through an injury or wrong done directly to the corporation, the shareholders being injured only because

the corporation in which they are interested is injured. However, the shareholders may institute proceedings against directors or officers if, as not infrequently happens, the corporation itself, being controlled by the wrongdoers, fails to take proceedings. In such a case, however, the shareholders demand redress for the corporation, not for themselves, and whatever may be recovered is recovered for the benefit of the corporation.

The duty of a director or officer of a corporation is analogous to the duty of any agent to his principal; that is, each officer or director must exercise reasonable diligence in the performance of his work and must observe fidelity to his principal. The application of these principles to particular facts is not always easy, but the principles themselves are clear. The degree of care which directors are bound to use presents a troublesome question of fact. In a small business it may be the duty of a director to take active control of the policy of the company and supervise with some minuteness each business operation. Such direction is impossible where a great railroad or industrial corporation is concerned. In such a case, directors necessarily derive their information from subordinate agents and cannot investigate facts for themselves.

Directors are not liable for mistakes of judgment if they use reasonable care. If, however, they wilfully do an act which they know is not authorized by the charter or by-laws of the corporation, they will be liable for the consequences. Directors who are cognizant of wrongs committed by their co-directors and who fail to take available measures to prevent the wrongs, become

liable themselves. Directors may terminate their liability for future acts by resigning, but resignation will not destroy liability for acts already done, even though the resulting damage does not happen until after resignation. A director or other officer should not act on behalf of the corporation in a matter in which he has a personal interest at variance with that of the corporation. Should matters of this sort arise, as they often do, the interested officer or director should not take part in the decision of the question; if he does so, he may render himself liable.

Duty of the Directors to Declare Dividends—Dividends on the stock of corporations are declared by the directors, who have power to use their discretion as to the amount to be disbursed in this way. Unless there is an abuse of discretion, stockholders cannot compel the directors to declare a dividend. However, the statutes are very explicit in prohibiting the declaration of any dividends except out of the surplus profits of the business conducted by the corporation.

With respect to dividends properly declared, the declaration of the directors generally provides that dividends shall be paid to all stockholders registered upon the books of the company as of a specified date. If, after the specified date, a stockholder should sell or otherwise transfer his stock to another person, the latter, while becoming the owner of the stock, would not be entitled to the dividend when paid. It would be payable to the former stockholder, although he might, pursuant to an agreement he made with the person to

whom he sold the stock, turn over to the latter the amount of the dividend.

Liability of Directors to Creditors—So long as a corporation is solvent, creditors of the corporation have no reason or right to seek redress from any one but the corporation itself. Creditors of an insolvent corporation, however, may enjoin action by the company's officers which is unauthorized or likely to prove detrimental to the assets of the corporation. If the officers knowingly misapply the assets of an insolvent corporation, they are personally liable to the creditors for the injury caused thereby. They are also liable for false statements of the condition of the corporation in reliance upon which credit is given the corporation. Like other agents, the officers of a corporation impliedly warrant, to persons with whom they deal, their authority to do the acts which they undertake; if authority is lacking, they are liable personally. The only qualification of this principle is that if the facts from which authority, or lack of it, may be determined are known to the person dealing with the officers, they are not liable; that is, they do not warrant the correctness of an inference of authority from known facts.

Liability of Bank Officers—The principles governing the liability of bank directors and other officers of a bank are the same as those which govern the liability of officers of other corporations. The bank laws, however, impose certain duties and penalties which affect the application of general principles. It may be worth

while to enumerate briefly some of the liabilities of bank officers. As to directors it has been said, "It is not necessary to show directly that the directors actually had their attention called to the mismanagement of the affairs of the bank or to the misconduct of subordinate officers. It is sufficient to show that the evidence of the mismanagement or misconduct was such that it must have been brought to their knowledge unless they were grossly negligent or wilfully careless in the discharge of their duties."

The directors are liable for the consequences not only of their own fraud but also of their ultra vires acts. They are liable for approving the discount of notes known to be worthless or of so doubtful value as to be obviously unsafe. If guilty of negligence in failing to discover that such paper is worthless, they are also liable. They are guilty of negligence and may thereby render themselves liable if they wholly neglect to ascertain from the books the condition of the bank, although a thorough examination of the books of a bank, especially of one transacting a large business, cannot be expected of every director. The law naturally would require no more than would be demanded by the standard of reasonableness.

The President—The duties of the president, and consequently his liabilities, must be determined by the general law, by the charter of the particular institution, by its by-laws, and by general business usage. If it is the general practice for the president to draw and sign checks in the absence of the cashier, the president has

authority so to act. He has authority to conduct the litigation of the bank; he may employ counsel. He may generally indorse the negotiable paper of the bank. On the other hand, he will be personally liable if he permits improper loans or overdrafts, if he fails to give proper instructions to inferior officers, if it is his duty to require a bond from an inferior officer and he fails to do so, and generally if he commits a breach of duty which causes damage to the corporation. He has no power to execute deeds of real estate without authority of the directors; generally an instrument which must be executed under the seal of the bank must be authorized by the board.

The Cashier—The supreme court of Maine has thus expressed the functions of the cashier of a bank: "A cashier, it is well known, is allowed to represent himself to the public as habitually accustomed to make payment for its bills or notes payable to other persons; to make payment for bills and notes discounted by the directors; to receive payment for bills of exchange, notes, and other debts due to the bank; to receive money on deposit and to pay the same to the order of the depositors. He is represented as having the custody of its books, bills of exchange, notes, and other evidences of debt due to it, and indeed of all its movable property. He is represented as making entries in its books and as keeping its accounts and a record of its proceedings. In many banks these duties are performed in part by tellers, clerks, or assistants, but generally, it is believed, under the superintendence of the cashier,

and he might at any time assume the performance of them, if able to do so, without such assistance. His true position appears to be that of a general agent for the performance of his official and accustomed duties. While acting within the scope of this authority he would bind the bank, although he might violate his private instructions."

The cashier must exercise proper supervision over subordinate officers; he must use reasonable care and skill. He may become liable personally for failure to observe instructions as to a special deposit, for the improper sale of stock held as security for a loan, for improperly making loans, for failure to give essential information to the directors, for failing to exercise proper supervision over inferior officers or agents, as well as in the more obvious case where he has taken advantage of his position to commit intentional fraud upon the bank.

Rights of Stockholders—A stockholder has the right to share in the profits of the corporation when a dividend is declared. He has no right to compel the declaration of a dividend unless there is an abuse of the discretion that directors possess with regard to declaring dividends. Unless he holds non-voting stock, a stockholder has a right to attend meetings and vote. He also has a right to inspect the books of the corporation, but he can claim this right of inspection only at a proper time and place. Courts generally insist that the stockholder must have a proper motive for inspecting the corporate books and that he cannot unduly harass the conduct of the corporation by this right.

Another important right of the stockholder is known as his pre-emptive right to subscribe to additional stock. If a corporation increases its capital stock by the issue of new stock, which can be done only by vote of the stockholders and in accordance with the statutes of the state, the stockholder has a prior right as against third parties to subscribe to as much of this new stock as will be necessary for him to maintain his proportionate interest in the corporation. Usually he is entitled to subscribe to this stock only at the market rate or at such rate as may be determined by vote of the stockholders. However, many states hold that the stockholder cannot be compelled to pay more than par value for the new stock.

Blue Sky Laws—Blue sky legislation represents an attempt on the part of the states to prevent the sale of worthless securities to innocent persons. In the sale of stock, as of anything else, there is no liability at common law for any statements that do not constitute fraud. Fraud, as we have seen, is a misstatement of a material fact for the purpose of inducing a prospective purchaser to buy. Expressions of opinion, no matter how exaggerated or how unfounded, do not constitute misstatements of fact. If one examines the average prospectus of a new stock being offered for sale to the public, he will find that when most of the high sounding terms and flattering statements are analyzed carefully, they will fall into this second class of non-actionable statements. There are few statements of fact but many glowing statements in the nature of seller's talk.

The Character of Blue Sky Legislation—The blue sky statutes of the various states differ in infinite details. We can only summarize the general characteristics of this type of legislation. The laws apply to dealers in securities, making the sale of securities in violation of the statute a crime. Such sales are illegal and hence voidable so that the buyer may recover his purchase price. Sales made by owners (unless made with such frequency as to put the owners in the class of dealers) and sales to a bank or to a dealer are usually exempt from the operation of the statute. Certain types of securities are also exempt, no matter by whom they may be sold, such as governmental and municipal bonds, bank stocks, first mortgage bonds, approved public utility securities, and securities regularly quoted or dealt with upon approved exchanges.

With regard to the securities covered by the statute, a dealer must file with the secretary of state an application for permission to sell them, and he must pay a fee based upon the amount he proposes to sell in the state. The application for permission must contain detailed information as to the character and powers of the issuing company, its properties, its business, and its stock issues. The application is examined by the proper state authority which then grants or withholds the permission, or grants it upon certain conditions. If securities are sold without complying with the law, severe penalties attach to the seller. Not only is the sale voidable so that the buyer can compel the dealer to refund the purchase price, but the dealer's license to sell securities may be revoked and he may be fined or imprisoned.

CHAPTER XI

Transfer of Stock

A SHARE of stock is the claim that its holder has to share in the profits of a corporation and, upon dissolution, in its property. This claim is evidenced by a stock certificate, and like any other claim it may be assigned. The methods and effects of transferring this claim by transferring the stock certificate are the subjects of the present chapter. The stock certificate is regarded as a quasi-negotiable instrument of commerce having attributes of negotiability very like bills and notes. About half the states have enacted the Uniform Stock Transfer Act. This act, like all other uniform commercial acts, lays down certain principles, the application of which in states that have passed the act tends to bring about a uniformity of procedure in the matter of transfer of stock.

The Nature of a Transfer of Stock—The transfer of stock from one person to another always involves two steps. In the first place, there is a transfer of the certificate from the transferor to the transferee. This act, however, only entitles the transferee to have the stock of the transferor transferred to him upon the books of the corporation. The transferee must deliver his certificate to the corporation, which will then enter the transfer upon its books and issue a new certificate to the transferee as evidence that he is now the owner of the stock. If these transactions are analyzed, it is

apparent that the first concerns the transfer of the original stockholder's claim and that the second involves the surrender of that claim by the transferee to the corporation in return for a new right of the transferee directly against the corporation.

Difficulties in Transfer Affect Purchaser and also Corporation—The difficulties involved in the transfer of stock may be considered (1) from the standpoint of a purchaser of the stock, including in the name of purchaser one who lends money on the stock as well as one who buys it, and (2) from the standpoint of the corporation whose duty it is to transfer the stock on its books. Generally the difficulties which confront the corporation when it is asked to transfer are the same as those which confront the purchaser. If the purchaser gets a defective right when he buys, then the corporation, if it transfers, will generally get into the same kind of trouble also.

Two Methods of Transferring Stock—Stock may be transferred in two ways: (1) by delivery of the certificate bearing upon it the indorsement of the owner of the stock which indicates that he assigns or authorizes the assignment of the stock, and (2) by delivery of the certificate, with an assignment executed in a separate document and attached to the certificate, the document stating that the owner of the certificate assigns or authorizes the transfer of the stock. The second method is not as good as the first; if for any reason the separate document should become detached from the

certificate, the transferee's right would not be apparent from the face of the certificate. Therefore, if a second purchaser in good faith should get possession of the stock certificate bearing an indorsement upon it, he would take precedence over the first purchaser who had only a separate paper evidencing the assignment of the certificate to him. Of course, after the transfer has been duly registered on the books of the company, it makes no difference whether that transfer was secured by means of a separate power of assignment or by means of one written on the certificate itself.

Effect of Delivering Unindorsed Certificate—What is the effect of giving a certificate without either of the formalities mentioned in the preceding paragraph? It virtually protects the person who receives the certificate. Although he does not have title to the stock and cannot get title without an indorsement, he has the certificate in his possession which prevents any other person from getting title. Furthermore, he has the right to require an indorsement from the person whose indorsement is needed, provided, of course, that the holder of the certificate took it from the owner who impliedly or expressly agreed that he should have title. If some one not an owner of a certificate delivers it without indorsement to a bank and borrows money on it, the bank will not be protected. The true owner can say, "That is mine," and take it away.

Effect of Transfer on the Books of the Company—What is the effect of transfer on the books of the com-

pany? Under the common law, stock was originally transferable just like any intangible right, that is, merely by agreement of the parties. When stock certificates became common, there was added to this requirement the delivery of the stock certificate itself. But it was inconvenient to have stockholders buy and sell without any notice to the company; the company wanted to know who were the owners of its stock. Therefore it became the common practice for a corporation to include in its by-laws a provision that stock should be transferred only on the books of the company.

The Uniform Stock Transfer Act goes back partially to the old rule, since the transfer of the certificate with the indorsement or separate assignment is what transfers the stock and not the transfer on the books of the company. But in order that the corporation may not be inconvenienced, the act further provides that the corporation shall have the right to pay dividends to those who are registered on the books of the company, such persons being the apparent owners, and the uniform act also provides that only such persons shall have the right to vote.

Ownership of Stock—Stock may be owned by a single individual, by several persons in common, by several persons jointly, or by a person in a fiduciary capacity, as a trustee, an executor, or a guardian. What is the difference between the ownership of stock by several persons in common and the ownership by several persons jointly? The common law drew this

distinction between joint rights and rights held merely in common: That a joint right survived to the survivors when one of the joint owners died, while a right held in common passed to the personal representative of the deceased. If A, B, and C own stock jointly, A and B are the owners when C dies. If A, B, and C own stock in common, A, B, and the executor of C are the owners on the death of C. At the present time when several persons own a right, they generally own it in common. There are two notable exceptions—partners and trustees. When A, B, and C are either partners or trustees, stock held in their names as partners or trustees will pass to A and B on the death of C. C's executor will not have to join in the transfer.

Legal and Equitable Difficulties in Transfers—The main difficulties which arise may be divided into legal and equitable difficulties. Legal difficulties involve cases in which the purchaser does not get a good legal title free from claims by any one else. Equitable difficulties involve cases in which the purchaser gets the legal title but the legal title is subject to an equitable right in favor of some other person. The equitable rights of other persons cannot prevail against those who are bona fide purchasers, that is, purchasers for value and without notice of the defect. Suppose B gets A to indorse a stock certificate to him by misrepresentations which amount to fraud. Because of the fraud, A can rescind the transfer and recover the certificate from B; that is, B has the legal title, but it is subject to A's equitable right to rescind for fraud. If,

however, B indorses the certificate to C, who pays him for it and who has no notice of B's fraud, A's claim cannot be asserted against C, for C as a bona fide purchaser cuts off A's equitable right. If C were a donee or if, even though he gave value, he knew of the fraud, A's equitable right would be good against him.

Forged Certificates—The certificate of stock may be forged. The purchaser of a forged certificate of stock gets nothing in the way of stock. He has only the right to sue the person who sold him the stock, on the ground of an implied warranty of genuineness. Suppose that the corporation receives a forged certificate of stock for transfer and completes the transfer by issuing a new certificate. Even though the person who takes the new certificate is a bona fide purchaser for value, he cannot get any stock in the corporation if all the authorized stock has previously been issued, for the corporation has no power to overissue stock. However, the bona fide purchaser does have a right against the corporation, since the corporation has issued to him what purports to be valid evidence of stock ownership. If he is a purchaser in good faith from the person to whom the purported stock was issued, he has paid for stock in reliance on a certificate which the corporation has issued. The corporation is estopped, as the legal phrase is, to deny the validity of that certificate as against one who has thus relied on its acts. The result is that the corporation is bound to pay him the value equivalent of the stock, because the corporation has put out something which seems to be good stock, and owing to the

act of the corporation in doing that the purchaser has been deceived.

Forged Assignments—A second legal difficulty arises where the indorsement or the assignment of the certificate is forged. Only the owner of stock can sell it. Consequently, if any one else attempts by forgery or otherwise to make a transfer, the transfer is ineffectual. The result is the same as though the whole certificate were forged. The purchaser under the forged indorsement gets nothing in the way of stock, but he has a right to sue the person who sold to him. If the corporation relies on the forged indorsement and issues a new certificate, it will be liable to a purchaser for value the same as in the case of a new certificate issued for a wholly forged one. It is of vital importance, therefore, to make sure that indorsements are correct, and it is desirable to take indorsed certificates only from reliable persons. If one takes a certificate from a reliable person, even though there is no express guaranty of signatures by a brokerage house or by any third person, he will be practically safe because of the seller's implied warranty of genuineness which applies to the indorsement on a certificate as well as to the certificate itself.

Assignments by Unauthorized Agent—A third legal difficulty arises where the indorsement is made by an agent who has no authority to act. In transferring stock, both the corporation and the purchaser should require the clearest evidence of an agent's

authority if the signature of the transferor is made by an agent. Not only is it necessary to be sure that the agent's authority originally existed, but it is necessary to be sure that his power has not been revoked, either by the death of the principal or by express revocation during his principal's life.

In regard to the agent's authority to make an indorsement, a troublesome question sometimes arises where the terms of the power given the agent are general, that is, where he is authorized to perform a very broad class of acts for the principal, but no specific mention is made of the particular certificate which he seeks to transfer. If this power does include the transfer of that certificate, the transfer is legally good, but a corporation would object to making a transfer under a power which did not specifically mention the particular certificate unless it was absolutely certain from the terms of the power that the certificate under consideration was included.

Lack of Capacity to Assign—A fourth case concerns the lack of capacity on the part of the owner of the stock to make a transfer. This lack of capacity may arise from a variety of causes, insanity, infancy, and the like. A totally insane person is as incapable of transferring stock as of transferring other property. An elderly person under the charge of a conservator is legally incapable of transferring his property. An infant, though not wholly without capacity if not under guardianship, presumably becomes wholly without capacity to transfer stock if under guardianship. Although

an infant who is not under guardianship could make a transfer, he could also, by virtue of his infant's privilege, revoke that transfer. Such a situation would be too insecure from both the purchaser's and the corporation's point of view. If stock is owned by an infant, a purchaser or a corporation should require that a guardian be appointed and that the transfer be made by the guardian.

Lack of Delivery—Theft of Certificate—A fifth difficulty exists where the signature on the back of the certificate is genuine, but where there has been no valid delivery by the owner. Lack of delivery is rather hard to detect. Suppose the head of a firm keeps "street certificates" of stock (that is, certificates made out in the name of the brokerage firm that was the former owner and indorsed in blank) without having the certificates transferred to his own name. He puts the certificates in the office safe to which his clerk has access. The clerk takes the certificates and sells them to a broker who has no knowledge that the certificates do not belong to the clerk. After the loss is discovered and traced by the numbers of the certificates, action is brought against the broker. At common law the liability of the broker would be much in doubt; the only thing that would prevent him from being liable to the owner of the stock would be the contention that the owner of the stock had been so negligent in his dealing with the certificates as to preclude him from asserting any right. The Uniform Stock Transfer Act, however, changes the common law rule. It makes stock certificates fully nego-

tiable. The lack of delivery becomes only an equitable claim which cannot be asserted against a bona fide purchaser of the stock, such as the broker.

Death of Owner of Indorsed Certificate—A somewhat similar case is that where the owner of stock dies after he has written his name on the back of the stock. Men often use their stock certificates to borrow money on; therefore, after payment of the loan, they have in their possession, usually in their safe deposit boxes, the certificates with their signatures on the backs. Suppose the owner of such an indorsed certificate dies and an attempt is made to transfer the stock by virtue of the signature written on the certificate. At common law such a transfer is not valid. The certificate is owned only up to the time of his death by the man whose name is on its face; on his death his executor becomes the owner, and the executor's signature is necessary to transfer the title. The signature of the deceased, written before his death, is not effective for the purpose of transfer, and yet a purchaser may not be aware that that signature is invalid; he may not know that the man who signed the certificate is deceased. The corporation also may allow the transfer to go through in ignorance that the signer is deceased.

If the proceeds from the sale of the stock actually reached the executor of the estate, of course he could not object to the validity of the transfer, and especially he could not object if he were in any way a party to the transfer of the stock by means of the signature of the deceased. However, if the proceeds did not get into

the hands of the executor and he were in no way responsible for the transfer, he could assert that the transfer was invalid and that the stock belonged to the estate of the deceased. This common law rule also is changed by the Uniform Stock Transfer Act. The lack of delivery during the owner's lifetime is not available against one who may qualify as a bona fide purchaser of the stock.

Bankruptcy of the Owner of Stock—Bankruptcy represents another important case in which the genuine signature of one who was the owner cannot transfer a good title. The Federal Bankruptcy Law provides that title to property which a bankrupt possesses at the time of his bankruptcy shall be vested in his trustee. Therefore, if a bankrupt seeks to transfer stock which was in his name at the time he was declared a bankrupt, he cannot do so. Since he is no longer the owner of the stock, he has no power to transfer it. Even a bona fide purchaser of the stock from a bankrupt will get nothing.

Attachment of Stock—A sixth difficulty in regard to transfer of stock—attachment of the stock by a creditor of the registered owner—is eliminated in states where the Uniform Stock Transfer Act has been adopted. Before the passage of the act such attachments created considerable difficulty. Suppose that on the books of the Pennsylvania Railroad Company A is the owner of 100 shares of stock. He knows that a creditor is about to attach the stock, and in order to

prevent the attachment he sells the stock on the exchange. If he makes the sale before the attachment, undoubtedly the sale will prevail over the subsequent attachment. But suppose the attachment preceded the sale of the stock. A still has the certificate, and brokers and purchasers are accustomed to rely on the certificate as evidence of ownership. They take the certificate and pay A money for it; then when the purchaser goes to transfer the stock he finds that an attachment has been put upon the books of the company. In states where the uniform act has not been adopted this difficulty may still arise, but where the uniform law governs the case, the only way to make an attachment of stock effective for the creditor or other claimant is to seize the certificate itself.

Transfers between Husband and Wife—One other matter of transfer deserves attention, and that is a transfer between husband and wife, or vice versa. In most states a married woman can contract as fully as a married man, but generally, though not universally, neither of them can contract with the other or make a conveyance directly to the other. A promissory note or any other conveyance or transfer or contract from wife to husband or from husband to wife was at common law invalid, and still is in many states. However, a husband can appoint his wife his agent, and a wife can appoint her husband her agent, and when such an agent acts, his or her acts will legally bind the principal, just as in any other case of agency. Accordingly, if a husband draws a check payable to his wife, although

he does not become liable as drawer to his wife and cannot be sued by her if the check is not paid, the bank runs no risk in paying the check because the husband has authorized the bank to make the payment to his wife.

Similarly, if a husband authorizes a corporation to transfer stock to his wife, it seems that the corporation is protected, having acted under the authority of the owner, and that the wife will get a good title to the stock. However, this question has been somewhat disputed by lawyers. It is very probable, therefore, that a corporation, as a matter of precaution, would refuse to run any risk by transferring directly from husband to wife, or vice versa, but would require that the transfer be made through a third person in any state where under the law husband and wife cannot contract with one another.

Stock Held in Trust—Let us now consider the equitable defects that arise in the transfer of stock. Such defects occur chiefly where stock is held in trust. It would be the simplest and pleasantest thing for a corporation if it could refuse to register stock held in trust, but it has been decided that a corporation cannot do this, that it is bound, if requested, to register stock in favor of a trustee and to issue stock to a trustee. A trustee holds under an appointment by the court; a trustee may cease to be such at any time by removal of the court, as well as by death. Suppose stock is registered in the name of D, trustee. If D ceases to be trustee because he is removed from office, a transfer by him

will not be valid. Accordingly, it is essential for a corporation and for a purchaser to be certain, not simply that D *was* trustee, but that D *is* trustee at the time he attempts to make the transfer.

To avoid complications, trustees sometimes do not specify in the certificates that they are trustees. Suppose a certain certificate held by D does not state that there is a trust. If the corporation or the purchaser of the stock has no notice that D is really holding the stock in trust, the corporation or the purchaser will have the same rights as if there were no trust; but if either the corporation or the purchaser learns from extrinsic sources that the stock is really held in trust, either one will be bound to make certain that the seller is still empowered to act as trustee, just as if the certificate specifically stated on its face that the stock was owned by D in the capacity of trustee.

One Having Notice that Stock Is Held in Trust Must Ascertain the Terms of the Trust—Even if the supposed trustee is actually the trustee, he may not have power to give a good title to the stock. Undoubtedly he has the legal title, but even if the certificate contains notice that he holds the legal title as trustee, a purchaser is bound at his peril and the corporation is bound at its peril to make sure that the trustee is authorized by the terms of his trust to transfer the stock.

A Trustee Has Powers Necessary to Carry Out the Terms of the Trust—Generally when a transfer

of stock is attempted by a trustee, it means that the trustee is selling the stock, although that is not necessarily the case. A trust may be terminated; that is, a trust may have been created for twenty years, with directions to the trustee to transfer the trust property to certain beneficiaries at the end of twenty years. A transfer by the trustee to the beneficiaries at the close of the twenty years would not be a sale of the stock; it would be a transfer for the purpose of carrying out the trust, and a trustee always has implied power to make any transfer of stock that is necessary to carry out the purpose of the trust.

Has Trustee Implied Power to Sell?—Generally speaking the answer is "no." The general duty of a trustee is to keep the property which is left to him in trust or conveyed to him in trust in its existing form, but there may be circumstances that would imply the power to sell. If no power to sell is specifically given in a trust created by deed or by will, a corporation will ordinarily require, and a purchaser should require, the trustee to obtain the authority of the proper court to make the sale. A carefully drawn trust generally contains a power for the trustee to sell if the purpose of the trust is to produce an income-bearing fund for a long period of years. For such a purpose a change of investment is frequently desirable, and therefore a trustee is expressly given the power to sell. But a purchaser who is taking a certificate from a trustee and a corporation which is issuing a new certificate to the purchaser from a trustee must find out at their peril

whether the trustee has been given such a power to sell.

A Trustee Has No Implied Power to Pledge—Another power of a trustee is the power to borrow on stock, to pledge it, or to use it for collateral security. Such a power is not implied and is not commonly given in trust deeds or wills. Therefore, a bank or other lender should not lend on certificates of stock which are made out to the borrower as trustee, or which are made out to any one as trustee. Of course, it is improper, even when the trust does give the power to borrow, to permit the trustee to use the money borrowed as part of his own assets, that is, to put it into his own general account. It is his duty to keep trust money separate; therefore, if the trustee has power to borrow, he should keep the funds which he borrows earmarked as trust property. However, as we have already said, a trustee will rarely have the power to borrow given him expressly in a trust deed or a will even for trust purposes.

A Trustee Cannot Transfer to Himself—Suppose a trustee is by deed or by will given power to sell and he asks the corporation to transfer the stock to himself. The corporation should not do it. The trustee has power to sell to any one else but himself; he cannot make a bargain with himself in regard to his trust property, and therefore the corporation should not allow the trustee to transfer the stock to himself.

Purchaser from a Trustee Is Not Bound to See to Application of Purchase Money—Although the corporation and the purchaser from a trustee are bound to see that the trustee is not making an unauthorized sale, provided they have notice that he is a trustee, neither the purchaser nor the corporation is bound to see that the trustee does not make an improper application of the money received from the sale of trust stock. In the current legal phrase, neither the purchaser nor the corporation is bound to see to the application of the trust money. However, if either the purchaser or the corporation had notice of a proposed misapplication of the trust money to be received for the stock, it would be improper to allow the transfer knowing that the proceeds would be misapplied, and the corporation or the purchaser under these circumstances would unquestionably be liable if the transfer were carried out.

An Executor Has Implied Power to Sell—Stock held by a guardian or by an executor is in many respects treated like stock held by a trustee. There is this difference, however, in the executor's position: That since it is his duty to reduce the estate to cash, he has in most states an implied power to sell, and this power does not have to be given him expressly in the will. The will, however, may restrict an executor's right to sell certain stock. Therefore, even in the case of an executor, it would be proper for a corporation, before allowing the transfer, to make sure that the executor's power had not been restricted by the will.

Transfer by an Executor to a Legatee—Generally the executor will seek to reduce the property to cash which will necessitate the transfer of stock in the estate to a purchaser. He may wish to transfer it directly to the legatee, or he may try to transfer it to himself. Unless he is the legatee of the specific stock in question, it is as improper for him as it is for a trustee to transfer to himself. Even though the executor is a pecuniary legatee or is entitled to payment for commissions, he has no right to take stock in lieu of such pecuniary legacy or commissions; he cannot make such a bargain with himself, although he may in regard to the legacy of another.

If the executor is a specific or residuary legatee, the question of his right to transfer to himself is the same as the question of his right to transfer to any other legatee. That right is subject to only one qualification. Creditors of an estate have the first right; legatees are not entitled to receive their legacies unless creditors have been taken care of first. Creditors have a fixed period, from the time when executors or administrators give bonds, within which to assert their claims. If they have not asserted their claims within that period, the claims are barred. After the time has expired, it is generally known whether the assets of the estate are sufficient to pay legacies, and it is usually then proper to allow a transfer to a legatee. Prior to that time, there is the possibility—which in a particular case may be very small or very large—that the creditors of the estate will exhaust the assets and the legatees will not be entitled to anything.

Lost Certificates—Occasionally a question arises in regard to a lost certificate. The Uniform Stock Transfer Act provides for this case in substantially the same way as the common law would deal with it if there were no statute, namely: The corporation may demand a bond to indemnify it before it issues a new certificate. This bond is essential for the reason that, should the old certificate turn up and be transferred to a bona fide purchaser for value, the corporation would be liable on the old certificate, and it would also be liable to a purchaser for value of the new certificate.

Interpleader of Several Claimants for Stock—If there are several claimants for stock, as sometimes happens, the corporation should file a bill of interpleader against the several claimants, asking the court to determine which one is rightfully entitled to the stock. Suppose A asks a corporation to transfer stock to him, presenting a certificate indorsed by B, but B notifies the corporation that he has been defrauded of the stock by A and that he elects to rescind the transfer to A and to demand the certificate back. The corporation cannot undertake to determine which of these parties is in the right; it must ask the court to do so.

The same situation not infrequently arises in a bank where money has been lent on stock and notice is given to the bank not to return the security to the borrower because he obtained it fraudulently or otherwise acted in violation of the rights of a third person in pledging it to the bank. If the bank is a bona fide lender, it is of course entitled to hold the stock for its own security so

far as this may be necessary to repay the loan. However, if the bank can get the loan repaid out of other securities unquestionably belonging to the borrower, it should do so and then ask the court to decide who is entitled to the disputed stock.

CHAPTER XII

Personal Property

IN the strict legal sense property is the aggregate of rights which one may lawfully exercise over particular things to the exclusion of others. "If a man were alone in the world," says Kant, "he could properly hold or acquire nothing as his own, because between himself, as Person, and all other outward objects, as Things, there is no relation. The relation is between him and other people, whom he excludes from the things." All things are not the subject of property; such things as the sea, the air, and the light obviously cannot be appropriated.

An illustration will make clear our definition of property. A takes his shoes to a cobbler to be repaired. When he calls for them, he does not have the price for the work, so the cobbler refuses to give them up. Both A and the cobbler have a property right in the shoes. The right to absolute ownership is in A—that is his property right. The temporary possession, however, is in the cobbler, and he may hold the shoes until he receives his compensation for repairs. When we use the term property in its lowest form, we mean the right to possession; in our illustration, the cobbler has the right to possession. When we use the term in its highest form, we mean the right of exclusive ownership; A's right to the shoes after he has paid the repair bill and secured the shoes again is illustrative of this use of the term.

The Rights of Ownership—Exclusive ownership implies four things: (1) the right of exclusive possession for an indeterminate time, (2) the right of exclusive enjoyment for an indeterminate time, (3) the right of disposition, (4) the right of recovery if the thing be wrongfully taken or withheld. This is not the idea one ordinarily has of the term property. One speaks thus of his watch: "I own this watch; it is my property." Property is a term with a double meaning. In the ordinary sense, property indicates the thing itself, rather than the rights attached to it.

Personal Property and Real Property Distinguished—Real property has been defined as consisting of lands, tenements, and hereditaments. To put it more simply, real property consists of land and anything that is permanently affixed to the land. Personal property embraces all objects which are subject to ownership except land. One fundamental difference between the two is that real property is generally considered to be immovable, while such property as is movable is usually termed personal property.

It is important that the distinction between the two forms of property be kept in mind because different results follow where the property is held to be one or the other. For example, on the death of the owner, real property passes to his heir or devisee, while personal property passes to the personal representative, that is, the executor or the administrator, and through him to the legatee or distributee. Again, in settling the estate of a deceased person, personal property is used first to

pay the decedent's debts. The modes of transferring real property and personal property differ. Real property is transferred by deed. Personal property may be transferred without any writing, and even in the case of a transfer of personal property by a bill of sale, the requirements for recording it are generally quite different from those relating to the recording of deeds of real property.

BAILMENT

Nature of a Bailment—A bailment is the transfer of personal property by one party to another for some specific purpose, such as for use, repairs, or safekeeping, with the understanding that it shall be returned or redelivered at the expiration of a stated time, or upon the completion of the purpose for which the bailment was made. The person transferring the property is called the bailor and the one to whom it is transferred is known as the bailee.

If A lends his lawn mower to B, a bailment for use is created. If he gives his suit to his tailor to be pressed, a bailment for repairs is created. A is party to a bailment for safekeeping when he deposits his silverware in a bank. The ownership of or title to the property remains with A in each case, while possession of the property lies with the bailee. That possession, however, is to be surrendered to the bailor upon the occurrence of a certain contingency such as demand by A if the bailment is gratuitous, or on the payment of charges if otherwise.

Duties of Bailee—The duties of the bailee are to exercise due care with respect to the article while it is in his keeping and to surrender it to the bailor at the expiration of the bailment. If he performs this duty of exercising the proper degree of care, he is not responsible for the loss of the article. If the tailor's shop is destroyed by fire through no fault on his part and A's suit is burned, the tailor is not responsible to A for the loss of the suit.

What constitutes the exercise of due care by the bailee varies with the circumstances, such as the nature of the bailment and the character of the article. A purely gratuitous bailee cannot be expected to take as much care of an article entrusted to him for safekeeping as of one that he has been paid a price to keep. The bailor should be satisfied if the bailee takes as much care of the property left with him gratuitously as he does of his own. The amount of care that a bailee should bestow upon the safekeeping of bonds is quite different from the degree of care he should bestow upon the safekeeping of a book. He would be negligent if he did not keep the bonds under lock and key, while he would be exercising sufficient care if he kept the book in his home.

These duties may, of course, be varied by contract between the parties. The bailee may agree to guarantee the return of the article under all circumstances; in fact, some bailees have this duty thrust upon them because of their peculiar position. On the other hand, the bailee may so arrange his contract as to relieve himself of any liability for loss even through his own negligence

unless, as in some cases, such a contract is against public policy and therefore illegal and unenforceable.

Bailment Distinguished from Sale or Loan—Suppose B borrows $100 from A and agrees to return the $100 the next day. This is not a bailment but a loan. B's obligation is not to return the specific $100 that he borrowed but only $100. He may use the $100 that he borrowed, for of course he borrowed it in order to spend it. The ownership of the $100 that B borrowed, not merely the possession, passed to him. Under these circumstances B is simply a debtor of A. If he loses the $100 through no fault of his own, he will nevertheless have to repay A the money; under the principles of contract, the loss of the money will not excuse B from his duty to repay the sum. Thus a bank is not a bailee of its depositor's money but a debtor. As in the case of the money, if B borrows a box of oranges from A agreeing to return a similar quantity, he is not a bailee. Suppose a farmer stores grain in a warehouse where his grain is mingled with other grain. He has not bailed his grain; he has sold it for a right to the return of the same quantity of grain, not the identical grain he stored.

Rights of Bailee—One of the most important rights of a bailee is his lien upon the property, that is, his right to retain possession of the thing until the bailor has performed his obligations under the bailment. It is a right entitling the bailee only to possession of the thing; he cannot use the thing nor sell it un-

less the contract of bailment so provides or unless such a procedure is permitted by statute. Not all bailees can assert liens. The most common type of bailee who possesses a lien is the artisan, one who does some work on the chattel and thus increases its value. Thus a watch maker, a tailor, or a carpenter possesses a lien upon the property bailed. Persons who store articles for hire also have liens, such as warehousemen or garage keepers. A carrier who transports articles has a lien to enforce payment of his freight charges. Statutes commonly give carriers, warehousemen, and other classes of bailees the power to sell the articles in order to enforce their liens.

Liens may ordinarily be asserted only against the bailor. Suppose A steals X's silverware and deposits it in a bank. Although the bank can assert a lien for storage against A, it cannot assert this lien against X who, as the true owner, can demand his property without tendering the storage charges.

Rights of Bailor—The bailor can demand the surrender of the article upon the fulfilment of his obligations under the bailment. Thus if A, having stored an article with B, tenders B the proper storage charges and B refuses to give up the article unless he receives more money, A can treat B as having converted the article and sue him for its reasonable value. To the bailee this often presents a difficult problem. Suppose A stores silverware with a bank, and then B claims that the silverware is his and demands its return. Perhaps the bank is uncertain as to whether A or B is its true owner.

If A is the true owner and the bank delivers the silverware to B, it will be liable to A for the value of the goods. If B is the true owner and the bank delivers the silverware to A, it will have to pay B. Under such circumstances the bank should file what is called a bill of interpleader; that is, it should turn the silverware over to the court and let A and B contest its ownership.

Another duty of the bailee is not to exceed the contract of bailment. Thus, if A stores his silverware with the X bank, that bank should not deliver it to the Y bank for safekeeping, unless such conduct is permitted under the contract of bailment. It is the obligation of the X bank to store the silverware itself. If it delivers the silverware to the Y bank and the silverware is accidentally and without fault lost or destroyed in the Y bank, the X bank will be held liable for the value of the silverware.

Consignments—When goods are sent on consignment, the consignee, the person to whom they are sent, is an agent for the consignor, the person who sends him the goods to sell. He is also a bailee of these goods. He does not have title to them but only possession with authority to transfer the title to buyers. Until the goods are resold, they remain the property of the consignor and are held at his risk. When the consignee has sold the goods, he must turn over the proceeds to the consignor. Usually a consignee can assert a lien upon the goods remaining in his possession for any commissions, advances, or freight charges owed him by the consignor under the consignment contract.

Innkeepers—Innkeepers follow a public calling, which means that they must receive as guests all orderly persons who apply, if they have sufficient room. They cannot pick and choose the persons with whom they will do business as the ordinary bailee can. Innkeepers are bailees of their guests' goods, but their liability as bailees differed at common law from that of ordinary bailees. The fear that they would connive with others to rob guests of their valuables led to the rule that innkeepers were absolutely liable for the safekeeping of such goods, unless the goods were lost as a consequence of the guests' own negligence, an act of the public enemy, or an act of God, which is a legal expression for some extraordinary and totally unexpected calamity of nature such as an earthquake, a tornado, or a flood. The innkeeper was liable for ordinary losses such as accidental theft or fire.

Modern statutes have reduced this stringent liability of the innkeeper by permitting him to post notices to the effect that he will not be liable for valuables of guests unless they are stored in the hotel safe. The innkeeper has a lien upon a guest's goods for the amount of the hotel bill. Under modern statutes he is usually given power to enforce this lien by selling the goods after a reasonable length of time.

Warehousemen—The acceptance of goods for temporary storage has become an important business. The liabilities of warehousemen are those of ordinary bailees. A warehouseman, however, issues warehouse receipts or documents that have a twofold purpose: (1)

They serve as receipts for the goods and as evidence of the contract of storage, and (2) they serve to furnish documentary title to the goods so that the goods may be sold or transferred while in the possession of the warehouseman. The use of warehouse receipts to furnish documentary title to goods will be considered later in connection with the carrier's bill of lading.

Carriers—Carriers, like innkeepers, follow a public calling and must accept all persons or goods offered for transportation. Like innkeepers, carriers are insurers against all kinds of accidents except those caused by act of God, by act of the public enemy, or by act of the shipper, that is, where the destruction of the goods is due to some defect in the goods themselves. For instance, if goods were struck by lightning in transit and destroyed, that would be an act of God and the carrier would not be liable; but if goods caught fire from any other cause, such as from neglect of an outsider or from the act of an incendiary, the carrier would be liable. Carriers commonly seek to contract themselves out of this stringent liability. They may do so to a certain extent, but it is against public policy for them to contract themselves out of the consequences of their own negligence; hence a contract which purports to do this is illegal and unenforceable.

The extreme liability of the carrier does not extend to damage caused by delay. The carrier is liable for delays in so far as they are caused by its own neglect, but otherwise it is not liable. A carrier has a lien for freight charges, and under modern statutes it may en-

force this lien by selling the goods. The carrier's stringent liability as insurer extends only while the goods are in transit, which means until the goods have been delivered at their destination and the consignee has had a reasonable length of time in which to remove them. After the goods have ceased to be in transit, the carrier's liability is reduced to that of a warehouseman.

Bills of lading are issued by carriers. A bill of lading serves as evidence of the contract of carriage and as evidence of the receipt of the goods; it furnishes a documentary title to the goods by means of which they may be sold and transferred while in the possession of the carrier. Provisions limiting the liability of the carrier for loss or damage to the goods while in transit are to be found in the bill of lading. The quality of the bill of lading as a documentary title to the goods will be considered later.

Railroad Commissions—In addition to the duty imposed by the common law to serve all without discrimination and at reasonable prices, carriers are subject to the supervision of commissions established by both the states and the United States for the purpose of seeing that railroads and other carriers properly perform their duties. In most states the railroad or public service commission has a great variety of powers for compelling railroads to give proper service. The chief function of the federal Interstate Commerce Commission originally was in regard to rates, but its powers have been enlarged by legislation to include a variety of other matters.

The Interstate Commerce Commission has the power concerning interstate commerce to say whether rates and practices are reasonable. A carrier is obliged to file with the Interstate Commerce Commission a schedule of its rates and regulations concerning rates, and it is also required to post these rates publicly in its stations. If any one objects to the rates, he must make a complaint before the Interstate Commerce Commission. This is the only form of redress permitted, and sometimes it is not an easy one for a person who is merely interested in a single shipment, because the expense of and delay in the proceedings before the Interstate Commerce Commission are such as to be prohibitive unless the complainant's financial interest in the matter is considerable. It is common, therefore, for shippers' associations to take care of questions regarding rates rather than leave them to individual shippers. Any contract made by a carrier for more or less than the scheduled rate is illegal and void.

Safe Deposit Companies Are Bailees for Hire—A special kind of bailee, of whom some mention should be made, is the safe deposit company. It has been questioned whether a safe deposit company is properly a bailee of the goods in the boxes to which the safe deposit company has no access. Of course the safe deposit company is in control of the general premises, and the holder of a box cannot have access to its contents without the assistance of the safe deposit company. Therefore, there is a sort of joint possession. The safe deposit company and the depositor who hired the box

have the full control of the goods jointly, but neither one of them alone has full control. It has been suggested that the safe deposit company is merely a sort of watchman, that its duty is to guard the property of which it is not in possession. However, the company does a little more than mere guarding, and it is generally held to be a bailee for hire, which means that it must take reasonable care of the goods in its possession.

Liability of Safe Deposit Companies for Loss of Goods—There have been some cases where the safe deposit company has been sued for goods which were missing, or which the depositor claimed were missing, from his box. If the court or jury is convinced that the goods have been lost from the box, the burden of explanation as to how the loss happened is placed upon the safe deposit company. The safe deposit company is liable for the acts of its servants and agents; hence carelessness in regard to duplicate keys to any of the boxes might render a safe deposit company subject to suit in case of loss through carelessness.

Liability of Deposited Goods to Garnishment—One of the most important questions in regard to safe deposit companies is this: Are the goods in the safes subject to legal process? Suppose a safe deposit company is garnisheed (that is, served with a trustee writ) in a suit against one who has a box. May the company answer that it has no funds or goods of the defendant in its possession? Yes, it may, for it has no control over the goods. One exception to this rule should be

noted, and that is where a bank or a safe deposit company has a separate trunk or box of a depositor in its possession. If it has a separate box, even though the box is locked and the bank has not the key, the bank cannot answer that it has no funds of the depositor; it must answer that it has a box, the contents of which are unknown to it. However, a box that is shut up in one of the regular steel safes of a safe deposit vault cannot be reached by the safe deposit company in the normal course of affairs unless the depositor unlocks his lock.

Liability of Deposited Goods to Attachment—Whether property in a safe deposit box is liable on a writ of attachment, in a suit against the owner, is not so clear. It has been held in one case that the property is so liable and that the levying officer has a right to go in and seize the goods. This will not often be attempted, however, because the officer will not know in what box the debtor may have goods and the safe deposit company will not tell him. The company is certainly under no obligation to help the levying officer. The regular way for a creditor to get at a debtor's goods which are concealed in the safe deposit box is by first making the debtor disclose on examination in court what property he has, and then getting an order from the court to compel the debtor to turn over what he has disclosed. The debtor must comply with such an order or be imprisoned until he does.

Search for Stolen Property—If stolen property were sought, a search warrant describing the property

might be presented to the safe deposit company, which would then have to permit the officer of the law to make a search for the goods described, but only for the goods described in the search warrant. In a certain New York case an officer of a safe deposit company allowed an officer of the law, on a search warrant for certain articles, to make a general examination of goods in its possession and to remove some bonds which were not specified in the search warrant. The safe deposit company was held liable.

Death of the Depositor—This question often arises: What is the situation on the death of the owner or renter of a safe? It is the same as in the case of the death of any bailor or depositor. The bailee must recognize the title only of the person who is appointed by law as the successor in interest to the deceased person. The safe deposit company has the right to demand proofs and identifications of persons who claim rights as representatives of deceased persons, and it should exercise this right.

Disputes—Sometimes a dispute arises between joint owners of a box. In such an event, the safe deposit company should recognize the right of none until the question at issue has been determined by the court. A bill of interpleader to determine which joint owner has the right should be filed in court.

Safe Deposit Company Has No Lien—A safe deposit company has no lien on the contents of a box

for anything due for rental. In that respect it is different from an ordinary warehouseman and a carrier, who have a lien on the goods in their possession for their charges. The reason for the difference is that a safe deposit company is not in such possession of the contents of a box as to establish a lien. If the renter of the box does not pay his bills, however, the company has the right to open the box and remove its contents, keeping them safe for the owner.

Right of Safe Deposit Company to Sue for Goods Wrongfully Taken—If goods are wrongfully removed from the box of a depositor, the safe deposit company, like any bailee, has a right to reclaim them, for it is the law that if goods are wrongfully taken out of the hands of a carrier, warehouseman, or other bailee, the bailee may bring an action at law for the goods and reclaim them from the wrongdoer. Since the bailee has the right of possession to goods while they are in his custody, he may be liable if he lets them get into the hands of any one other than the true owner.

PLEDGE

Nature of a Pledge—A pledge is a special type of bailment. In a pledge, property is entrusted to a creditor to hold as security for a debt. The pledgee must take and retain possession of the property in order effectively to create a pledge. Certificates of stock, bonds, and notes are common objects of a pledge. A common transaction that is generally considered to be a pledge

is the purchase of stock on margin. The customer, or pledgor, owns the stock and is indebted to the broker for the balance of the purchase price, while the broker, or pledgee, retains possession of the stock in order to secure his claim against the customer.

Rights of the Pledgor—The pledgor is entitled to the return of the pledge upon payment of the debt. He can also assign his interest in the pledge to any other person, that interest being the difference in value between the pledge and the debt. The assignee then possesses the right to redeem the pledge. Usually the pledgor is entitled to the return of the specific property pledged, but when that property consists of corporate stock indorsed in blank or of similar fungible goods, he is entitled only to the return of a similar amount of property.

Rights and Duties of the Pledgee—Not only is the pledgee entitled to retain the pledge as security until the debt is paid, but he may also retain possession of any increase in the value of the pledge, such as interest on notes or dividends on stock. However, he must account to the pledgor for all such increases when the pledge is redeemed. The pledgee's liability for loss or destruction of the pledge is the same as that of any bailee; that is, he is liable only for his negligence.

The pledgee is under no duty to preserve the security value of the pledge. Thus, if stocks are pledged and these stocks depreciate in value, the pledgee is under no duty to sell them to avoid a loss; he may, if he chooses,

allow them to decline in value. Upon default of the debt, the pledgee may sell the pledge at a public sale after reasonable notice to the pledgor of the time and place of the sale, so as to give the pledgor a reasonable opportunity to redeem the pledge; but the pledgee himself cannot purchase the property at such a sale. In stock brokerage contracts it is commonly provided that upon default or failure to maintain the security value of the pledge, the broker may sell the stock on the exchange. In any case, a surplus above the amount of the debt must be returned to the pledgor. The pledgee may provide in the contract that he may sell the pledge without notice, but he cannot agree that upon default the title to the pledge shall vest in him, for such an agreement is regarded as so oppressive to the debtor as to be illegal. The pledgee can assert his right to possession only against the pledgor or his assignee. Thus, if A steals B's chattel and pledges it to X, X cannot assert this right to possession against B. If he is in doubt as to who owns the chattel, he should turn the pledge into court and file a bill of interpleader.

Repledging—One of the important rights of the pledgee is his right to repledge the article. In such a case the pledgor must redeem the article from the repledgee. But the pledgee cannot repledge for any longer maturity or for any larger sum than was originally agreed upon. Such wrongful repledging, however, often happens. If it is done, the repledgee cannot assert any greater right than the pledgee had against the pledgor. However, when the pledge is negotiable, such as bearer

bonds or stock certificates indorsed in blank, the repledgee may assert whatever rights the pledgee sought to give him provided that he acted in good faith, but such wrongful repledging makes the original pledgee liable as a converter to pay the value of the pledge.

By repledging, the original pledgee does not lose his contract claim against the pledgor. Thus, if A has pledged an article to B to secure B's claim against him for $100 and B then repledges the article to C to secure C's claim against B for $200, A can sue B for the value of the article, but B can counter-claim against A for the value of the original debt of $100. If A sought to get the article back from C, he could demand it upon tendering C $100 unless the pledge was negotiable, in which case A would have to tender C $200 in order to get the pledge.

Contracts Affecting Pledgor's Rights — The pledgor and the pledgee may alter their respective rights by contract except where such a contract would be against public policy and hence illegal. Thus, the pledgor may agree that upon default the pledgee may sell without notice, that the current market value of the pledge shall never fall below a prescribed minimum, that the pledgee may retain the pledge not only as security for a particular debt but as security for any other debts owed the pledgee by the pledgor, or that the pledgee may repledge for any sum that he may choose. Such provisions generally accompany a contract between a broker and a customer for the purchase of stocks on margin.

CHAPTER XIII

Personal Property—Sales

SALES should be distinguished from contracts to sell. A sale is an actual transfer of property for a consideration called a price, while a contract to sell is an agreement to make a sale in the future. Sales at shops, for instance, are often made without any contract to sell. The property is transferred in return for the price. However, when goods are ordered from a distance, an agreement to sell and ship usually precedes the actual sale of the goods. The sale is thus made in pursuance of the prior contract to sell. Like any contract, an agreement to sell goods must be supported by consideration to be enforceable.

Transfer of Title

Formalities Necessary for Sale—In the transfer of real estate the formalities of deed and seal are necessary. Such formalities are not required for the sale of personal property, which is subject to rules different from those for the sale of real estate. However, certain formalities are required in certain cases. The local statutes of frauds, modeled upon the English Statute of Frauds, have placed certain qualifications upon the right to make an oral sale or an oral contract to sell. Similar provisions are contained in Section 3 of the Uniform Sales Act, which has been adopted in about half the states.

Under the Uniform Sales Act, the restrictions apply to sales of or contracts to sell goods only of the value of $500 or upwards. In order for the sale or the contract to sell to be enforceable in such cases, one of the following three things must be done: (1) The buyer must accept part of the goods so contracted to be sold, and actually receive them; or (2) he must give something in earnest to bind the contract or in part payment; or (3) there must be some note or memorandum of the contract or sale in writing signed by the party to be charged or by his agent. The memorandum that is required to satisfy the statute must contain all the main terms of the agreement and *must be signed by the party to be charged or by his agent.* These provisions do not apply to contracts for the sale of something which is to be manufactured by the seller especially for the buyer and which would not be suitable for sale to others in the ordinary course of the seller's business. Thus, if A orally contracts to buy a special type of speedboat which is to be made according to specifications drawn up by him, such a contract does not fall within the statute. On the other hand, if A orally contracts to buy a standard model type of speedboat which the seller agrees to build, the contract does fall within the statute.

Capacity of Parties—The same rules that govern the capacity of parties to contract, generally, govern the capacity of parties to buy and sell. When a sale of goods is made to a person who is incompetent to contract, such as an infant or an insane person, the buyer may rescind the transaction just the same as he may

rescind any other contract. If the goods sold are necessaries, of course the infant or insane person must pay a reasonable price for them.

Importance of Distinguishing Sale from Contract to Sell—Why is it important to distinguish between a contract to sell and a sale? A contract to sell, as we have said, is simply an agreement to transfer the property or the title to certain property, while a sale is the actual transfer of the property or title. What difference does it make whether or not the title has passed? The principal consequence flowing from the actual transfer of title is that as soon as the title has been transferred from the seller to the buyer, the seller is entitled to the price. If the buyer refuses to take the goods prior to the transfer of title, the seller is entitled only to damages, which would be the difference between the value of the goods which the seller still retains and the price promised. If the goods are worth as much as or more than the amount of the price promised, of course the seller is not entitled to any substantial damages. But after title has passed, the buyer must pay the full price, and the seller may recover the full price if the buyer refuses to accept delivery.

Another consequence flowing from the actual transfer of title is that the goods are thereafter at the risk of the buyer. If they are destroyed by accident after title has passed, the buyer must nevertheless pay the price, for the right to the price accrued to the seller before the goods were destroyed. In cases of bankruptcy it is important to determine who holds title to the goods.

If the buyer becomes bankrupt after title to the goods has passed to him, his trustee in bankruptcy takes the goods for his creditors; if he becomes bankrupt before title has passed, the right to the goods is in the seller. The bankruptcy of the seller would make a similar difference.

When Title Is Presumed to Pass—The passage of title depends upon the intention of the parties. They may agree to have it pass at once or not until delivery of the goods is made. Ordinarily, the intention of the parties in regard to the transfer of title is not stated in express terms; consequently, the law creates certain presumptions as to when title is said to pass. If the parties simply bargain for the goods without saying anything about the time when the buyer is to become the owner, the first presumption is that title passes as soon as the goods have been specified and the parties have agreed on the terms of the bargain, even though no part of the price has been paid and though the goods still remain in the hands of the seller. It is often assumed that delivery is essential to transfer title to goods, but this is not so. Delivery is strong evidence of an intent to transfer title; that is, if delivery is made, it requires strong evidence to show that no title has passed. But the fact that there is to be delivery later does not negative the fact that title may pass before such delivery.

A second presumption is that if something remains to be done to the goods by the seller to put them in a deliverable condition, this indicates an intent that title shall not pass until the goods are in the condition agreed

upon. Sometimes the intention of the parties with regard to the transfer of title may be gathered from their actions or words. If the parties provide that the goods shall be stored for a time at the expense of the seller or at his risk, this indicates that title is not intended to pass immediately, for if they are at the seller's expense or risk, presumably they are still his goods. Again, payment of the price is evidence tending to show an intent to pass title, for business men do not ordinarily pay the price in advance. It is not uncommon for credit to be given by the seller, but it is uncommon for the buyer to pay first. However, even that is not impossible. Therefore, although payment of the price is evidence of an intent to transfer title immediately, it is not conclusive evidence.

Transfer of Title by Subsequent Appropriation—When title does not pass immediately, due to the fact that the parties so agree or that the goods are not specified at the time the bargain is made or that something remains to be done to them by the seller to put them in a deliverable condition, it may pass at a later date in several ways. It may pass by an express agreement of the parties, made later, that the buyer shall take title and that the seller shall give title. Frequently it passes by what is called an appropriation of the goods by the seller to the buyer, without any express later assent of the buyer but by virtue of an implied assent of the buyer given in the original agreement that the seller should so appropriate the goods. What is meant by appropriation is indicated in the illustrations which follow.

Appropriations by Delivery to a Carrier—Suppose A contracts to sell and ship to B 100 cases of shoes and B contracts to receive and pay for them. At the time of the contract the shoes have not been made and therefore have not been specified; consequently no title can pass at that time. Later the seller finishes the shoes, packs them, and delivers them to a carrier for shipment to the buyer. The shipment to the buyer is an appropriation of the goods. The very 100 cases with which the seller intends to fulfil his part of the bargain are indicated by the delivery of them to the carrier, and since the buyer agreed in the first place that the shoes should be shipped, he has assented to the appropriation. The presumption is that title passes to the buyer as soon as the goods are delivered to the carrier. This is by far the most common case of appropriation by the seller in accordance with the authority given by the buyer in his original agreement.

Suppose that A, a minor, who lives in an outlying suburb of Boston where the sale of tobacco to a minor is not permitted, wishes to purchase some cigars of S. S. Pierce Company in Boston. The title must pass to him in Boston, for if it passes in the suburb, the sale will be illegal. How is the transaction to be handled so that the company will not be guilty of making an illegal sale? Of course, A can go to the company's store in Boston, pay for the cigars in Boston, and send them to his residence at his own expense. But suppose he sends an order by mail. The company must not deliver the cigars by its own wagon, for title to them will remain in the company until delivery at A's residence.

If S. S. Pierce Company is willing to charge the cigars to A, giving him credit, it can send them by express or by mail, for as soon as the cigars are delivered to the public carrier in Boston, the carrier becomes A's agent, and the title passes to A in Boston.

The Seller Must Follow Exact Authority Given Him—Suppose the buyer specifies that the goods are to be shipped by a given route, but the seller ships them by a different route. Title will not pass on delivery to the common carrier in this case because the buyer has not authorized the seller to appropriate the goods to him in that way. It may be that the seller's way of sending the goods is better than that originally assented to by the buyer, but if the seller wishes to hold the buyer as owner of the goods from the time of shipment, he must obtain the buyer's approval of the better way. Still more important than the method of shipment is the character of the goods themselves. By shipping any goods the seller cannot transfer title. He must ship the very kind of goods which the buyer agreed to receive. If the goods sold are shoes, they must be merchantable shoes of the character and sizes which the buyer agreed to take. The goods must be properly packed, and all the usual precautions in regard to them must be taken. In so far as the original agreement specifies what is to be done, those things must be done. In so far as the original agreement does not specify how the goods are to be shipped or what shall be done in regard to them, the seller has discretion to do anything which is customary and proper for a careful business man to do.

Shipment of Goods C. O. D.—There has been considerable litigation in regard to the effect of shipping goods c. o. d. Suppose that goods of the sort ordered are shipped in accordance with the directions given in the order but are marked c. o. d., which means collect on delivery. Two possible explanations may be given of the effect of shipping the goods in this manner. One is that the seller retains not only control of the goods but also the title to the goods until they are delivered and the price is paid. According to this view the carrier is the seller's agent, empowered to hold the title to the goods and to transfer it to the buyer when he pays for the goods. The second and better view is that the carrier merely retains a hold on the goods, a lien on behalf of the seller, while title to the goods passes to the buyer on shipment.

C. I. F. Contracts—Contracts to sell are often made in a form known as c. i. f. contracts. These letters stand for cost (that is, cost of goods), insurance, and freight. In the absence of anything in a c. i. f. contract to indicate the contrary, the seller completes his contract when he delivers the goods to the shipper, pays the freight charges to the point of destination, and forwards to the buyer the bill of lading, invoice, insurance policy, and shipping receipt showing payment of the freight. Since he has done everything that is required to fulfil his part of the contract, the title to the goods presumptively passes on delivery of the goods to the carrier, and during shipment the risk of loss of the goods is on the buyer.

Sales F.O.B.—Another provision commonly found in sales contracts is the statement that goods are sold f. o. b. a certain destination. These letters, meaning free on board, indicate that the seller bears all carrying expenses until the goods are delivered at the place named. Presumptively title passes on the arrival of the goods at that place, for until then all expenses are borne by the seller. The place named may be either the point of shipment or the point of destination, but wherever it is, the title remains in the seller until the goods have been delivered at the place named unless the terms of the contract make some other provision regarding passing of title.

Effect of the Form of the Bill of Lading—Most shipments of goods are now made under bills of lading. Usually such a document contains a provision regarding the transfer of title, and reference must be made to the bill of lading to determine whether the title passes on shipment of the goods or whether it is retained until they reach their destination. Thus, by means of a bill of lading, the title may be retained or transferred at will. The nature of the bill of lading and its effect upon the transfer of title will be considered in more detail in a subsequent chapter.

DELIVERY

Importance of Delivery—As between the buyer and the seller, the intention of the parties will control the transfer of title, and title may pass before delivery.

As against creditors and third parties, delivery often becomes necessary to perfect a transfer of title from seller to buyer. Suppose that A sells a stock of goods to B but that A retains possession of them. To the outside world A's position has apparently been unaltered. His assets seem as many as before, and persons not knowing of the sale would be just as willing as before to extend credit to him. A is also ostensibly the owner of the goods, and a prospective purchaser who had no knowledge of the sale to B naturally would so regard him.

For the protection of other persons who would rely upon A's ostensible ownership of the goods, there has developed a rule of law that delivery is essential to perfect B's title as against them. If, after the sale to B, A sells the same goods to X who, without knowing of the sale to B, pays value for them and takes delivery, X can keep the goods as against B. Although A lacks title to the goods, he is deemed to have a power under such circumstances to vest a good title in a bona fide purchaser. As against creditors of A, the retention of possession by him is regarded as evidence of a fraudulent intent on his part to make a colorable sale to defeat his creditors. That being so, the creditors can bring an action to set aside the sale to B and levy upon the goods as if they belonged to A.

Place of Delivery—Certain contractual rights between the buyer and the seller are implied from the nature of the bargain of sale. A seller is under an implied obligation not only to transfer title to the buyer, but

also to deliver possession to him. Where must the seller deliver possession? If the contract states the place, the terms of the contract decide that question. If the contract does not expressly state the place of delivery, the seller's residence is the place where the seller is bound to deliver unless the goods are too heavy for easy transportation. In the latter case, the place of delivery is the place where the goods are at the time of the bargain; it may or it may not be the seller's place of business.

Delivery and Payment Are Concurrent Conditions—Concurrently with the seller's duty to deliver possession, the buyer is under a duty to pay the price unless the contract provides for a period of credit. In other words, in the absence of a contrary agreement, the delivery and the payment of the price are concurrent conditions. The seller must offer to deliver if he wants to have a right of action for the price, and the buyer must tender payment if he wants to have a right of action for the goods. The tender of price and the delivery of the goods must be at the place where payment and delivery are due. But how is the seller to tender the goods at the place delivery is due, that is, the seller's place of business, if the buyer does not appear? It is in effect a tender for the seller to have the goods in the place where they are to be delivered and be ready and willing to deliver them. If the seller is ready to deliver at the place where performance is due, or if the buyer, with his money, is at the place where payment is due, there is in effect a tender to perform.

WARRANTIES

Express Warranties—The warranties of a chattel may be either express or implied. An express warranty is a promise given by the seller that certain facts relating to the goods are true. The promise need not be made in words of a promissory nature. If the seller makes any statement of facts that would naturally induce the buyer to purchase the goods, the law treats the statement as a promise by him that the facts are true. The simplest form of warranty is where the seller says, "I guarantee that this horse is sound," or "I promise that this piano will stay in tune for a year." These promises are subject to the same rules as other promises; they are contracts for a consideration, the consideration being in each case the purchase of the goods. Suppose that A, who is trying to sell a horse, says that the horse is perfectly sound, that he is four years old, that he is broken to harness, and that he has trotted a mile in three minutes. In form these are representations rather than promises. It is possible that when A makes them he does not understand that he is binding himself for the truth of his statements. However, if they are made as positive statements of fact with the intention of inducing the buyer to purchase the horse, and the buyer does purchase the horse in reliance upon them, A is held to have warranted the truth of his statements.

Representations of Fact and of Opinion—To be a warranty an affirmation must be of a fact; statements

of opinion relating to goods are not regarded as express warranties. If the seller says, "I believe this horse can trot a mile in three minutes any day," clearly he is not making a warranty. Even the statement "The horse can trot a mile in three minutes" would probably not be considered a warranty; but the statement "The horse has trotted a mile in three minutes" is a direct assertion of fact and therefore is a warranty. Statements of value do not amount to warranties; they are necessarily to a large extent mere matters of opinion. But if the seller says, "I have just purchased this horse from X, and I paid him $1,000 for it," he is making a statement of fact and not of opinion.

General statements with respect to quality present difficult problems. Are they statements of opinion or of fact? Suppose a seller says to the buyer, "This machine will certainly do your work," or a manufacturer says to a jobber, "These articles will sell well in your community," or a broker tells his customer that a particular bond is "an A1 bond." Are these statements of fact or merely expressions of opinion? In dealing with cases of this nature, the courts have had great difficulty in drawing the line between allowable seller's puffing and the point where the buyer becomes justified in assuming that the seller is making statements of positive fact and not merely voicing enthusiastic hopes.

Express Warranties Independent of Intentional Misrepresentation—It is wholly immaterial whether or not the seller knows that his statements of fact are false. A warranty is a promise, and it makes no dif-

ference whether it is made by an innocent seller or by a deceitful one. If the statement is untrue, there is a breach of the warranty. Warranties are also independent of the seller's negligence. If the seller does his very best to make a particular article free from the defects against which he warranted it but fails to do so, he will have broken his warranty and be liable.

Implied Warranties—Implied warranties are obligations imposed by the law upon the seller from the very fact of the sale. No representation of any type need be made by him; the mere fact of the sale itself fixes him with these implied obligations just as if he had expressly made them. Of course, a seller may expressly say that he does not make this or that particular warranty, or the circumstances of the sale may be such as to indicate that a particular implied warranty is not made, in which case no such warranty will be implied by the law; otherwise, certain implied warranties will be deemed to accompany the sale. In this respect sales of personal property differ entirely from sales of real estate. In the case of real estate, the buyer gets no warranty except what he bargains for. If he gets a deed without words of warranty and it turns out that the seller had no title, the buyer has no redress unless there was intentional misrepresentation by the seller. The buyer cannot recover his money even though the seller had no title to the land.

Implied Warranty of Title—The first implied warranty that exists in a sale of personal property, un-

less the contrary is expressly agreed, is the implied warranty of title. The seller impliedly warrants that he has title to the property and that he will transfer title to the buyer. The only exception to this rule is where a sale is made by a person acting in a representative capacity, that is, by a sheriff, by an auctioneer, or by an agent. Here the circumstances are such as to indicate that the person making the sale does not impliedly warrant the title. In the case of an agent, however, the principal will be liable as an implied warrantor of title if the agent is authorized to make the sale; if the agent is not authorized to make the sale, the agent will be liable as warranting his authority—not as warranting title to the goods, but as warranting that he had a right to bind his principal. Even in the case of a sale by an agent, therefore, the purchaser gets substantial redress if the title turns out to be defective. Of course, it is possible, by express agreement, for a buyer to buy and for a seller to sell merely such title as the seller may have; but in order to induce a court to give this construction to a sale of goods, there must be an apparent agreement that such was the intention.

Implied Warranty of Quality in Sales by Description—Not only is there an implied warranty of title, but there are also implied warranties in regard to the quality of goods. The fundamental principle back of an implied warranty of quality of goods is this: If the buyer justifiably relies on the seller's skill or judgment to select proper goods, then the seller is liable if he does not deliver the proper goods. In connection

with implied warranties of quality, sales of specified goods should be distinguished from sales of goods by description. In the case of sales by description, there is always an implied warranty that the buyer shall have not only goods which answer that description but merchantable goods which answer that description. If a seller contracts to sell 100 hogsheads of Manila sugar, he must furnish merchantable Manila sugar, that is, Manila sugar of average and salable quality. It does not have to be the best, but it must be ordinarily salable as merchantable Manila sugar.

Implied Warranty of Quality in Sale of Specified Goods—Suppose A goes to an automobile dealer and purchases a particular machine. It is delivered, but owing to defects in manufacture, it breaks down the first time A runs it. May the seller say, "You looked at what we had in stock, and this is the machine you agreed to buy"? It is in this class of cases that the question of justifiable reliance by the buyer on the seller's skill and judgment becomes important, and in determining whether the buyer justifiably relied on the seller's skill and judgment, several things must be considered. Naturally, the first questions to settle are whether the defect was discoverable upon inspection and whether there was an opportunity to inspect the goods. If both of these questions can be answered in the affirmative, there is less reason to suppose that the buyer was relying on the seller's skill and judgment than if the defect was latent and was not open to inspection.

Implied Warranty Where the Seller Is a Manufacturer—What is the nature of the seller's business? Is he a manufacturer of the goods in question? The strictest rules of implied warranty of quality are applied against the manufacturer. The manufacturer ought to know about the goods he produces, and the buyer naturally relies on him to furnish goods of proper quality. Therefore, unless the buyer rather clearly assumes the risk of picking out what is satisfactory to him, the seller who is a manufacturer will be held to warrant the merchantable quality of the goods which he makes and sells.

Implied Warranty Where the Seller Is a Dealer—The next grade below a manufacturer is a dealer in the particular goods. He cannot have the same knowledge as the manufacturer; nevertheless, a dealer in goods of a particular kind is much more competent to judge of their quality than is an ordinary buyer. Therefore, unless there is special reason to suppose that the buyer did not rely on the dealer's judgment, the dealer will be held to warrant that the goods are merchantable.

Implied Warranty of Fitness for a Particular Purpose—Sometimes goods may be perfectly merchantable but wholly unfit for the particular purpose for which they are bought. When will the seller be said to have made an implied warranty of the fitness of the goods for such a particular purpose? Again the principle involved is whether the seller knew that the buyer was justifiably relying upon him to furnish goods

which would be fit for the particular purpose in question. Therefore, the seller must know the purpose for which the buyer wants the goods, and he must realize that the buyer relies upon him to use his skill and judgment in supplying the wants of the buyer. Suppose, for example, a buyer agrees to buy glue of a manufacturer who knows that the buyer is a furniture manufacturer. The glue manufacturer sells the buyer glue which is merchantable but not good furniture glue, as furniture glue must be of unusual tenacity. In this case, the seller is liable under an implied warranty. He knew that furniture glue was wanted. As a glue manufacturer, he ought to have understood that the buyer was looking to him to furnish glue of a sort that would fulfil the purposes which the buyer had in mind.

Known, Described, and Definite Articles—On the other hand, if the buyer orders what is called a known, described, and definite article, he takes upon himself the burden of determining whether or not the thing which he buys will fulfil his purpose. For example, a buyer in Missouri orders by number two boilers which are described in minute detail in the catalogue of a boiler manufacturer. The boilers are good under ordinary conditions, but the amount of mud in the Missouri River, the waters of which are to be used in the boilers, is so great that they cannot be successfully used there. In this case, the buyer has no redress against the seller, for he has taken upon himself to specify the particular kind of boilers he wants. They are merchantable boilers of the kind specified; the only

trouble is that they are not fit for use in the place where the buyer intends to use them. If the buyer had simply ordered boilers for a factory on the Missouri River, the result might well have been the other way, for he would then have placed on the seller the duty of furnishing something that was suitable for a factory on the Missouri River.

Remedies for Breach of Warranty—The remedies open to the buyer for breach of warranty are three in number. In the first place, where the breach of warranty is apparent to the buyer when the goods are delivered, he may refuse to accept the goods and sue for breach of warranty.

The second remedy is that where he discovers the breach of warranty only after he has accepted the goods, he may in most states return the goods and demand the purchase money back. But he must actually try to return the goods and not merely propose to do so or notify the seller that the goods are being held for him. Furthermore, he must elect to avail himself of this remedy within a reasonable time after he has discovered the breach of warranty; if he delays, he will have to fall back on another remedy. If he knew of the breach of warranty when he accepted the goods, he could not later return them and demand the purchase money back.

The third remedy, which is universally allowed, is to sue for whatever damage the breach of warranty may have caused. For instance, a seller sold a pair of sheep to a buyer with a warranty, express or implied, of their soundness. The sheep had an infectious disease.

When put with a large flock of the buyer's sheep, they infected the whole flock, and the damage was the loss of the whole flock. Another actual case was based on an implied warranty of the quality of rags sold to a paper manufacturer. The rags came from Turkey and contained smallpox germs. They gave smallpox to the operatives in the buyer's mill, and the mill had to be closed down, which caused great loss to the manufacturer. The entire loss was recovered from the seller of the rags, even though he was not negligent in bringing the result about.

Only Original Buyer Can Recover on a Warranty—No one can recover on a warranty except the original buyer. For instance, the operatives who caught smallpox could not sue the seller unless the seller had been negligent. If he had been careless or negligent in disregarding their safety, they could sue him in an action of tort, although they had no contractual relationship with him. If the buyer resells the goods, the purchaser from him cannot sue on a warranty given by the original seller to the original buyer.

Effect of Accepting Defective Goods—One effect of accepting known defective goods is that such acceptance debars the buyer from thereafter returning the goods on the ground that their defective character constituted a breach of warranty. But does the acceptance of goods known to be defective debar the buyer from claiming damages due to such defects? Suppose a certain quantity of sugar is offered to a buyer and the

buyer realizes that it is defective in quality. Can he still take the sugar and hold the seller for damages amounting to the difference between the value of the sugar that the buyer actually received and the value of the sugar that the buyer should have received under the contract? Can the seller say, "You should have objected to the defect at the outset and refused to take the sugar; your taking it is an acceptance of it in full satisfaction, and any right you may have had is now gone"?

It is the law of most, but by no means all, states that taking the goods does not necessarily indicate assent to receive them as full satisfaction of the seller's obligation. The buyer may receive the defective goods as full satisfaction, but the mere fact of taking them does not prove it. It is advisable, however, for the buyer to protest against the defect as soon as he sees it. In most states he may safely take the goods if in taking them he says, "These goods are defective, and I do not take them in full satisfaction." If he does not discover the defect immediately on taking the goods, he ought to give notice as soon as he does discover that the goods are defective and state that, although he proposes to keep them, he does so subject to a claim for their defects.

REMEDIES OF BUYER AND SELLER

Seller's Rights When Title Has Passed—If the title to the goods has passed, the seller may sue for the price. His right to the price is secured by a lien on the goods as long as the seller retains possession of them. He may enforce this lien by selling the goods after the

buyer has been in default an unreasonable length of time, but unless the goods are perishable so that an immediate sale is necessary, the seller should notify the buyer of his intention to sell before he actually sells.

Stoppage in Transit—If the seller has parted with both the title and the possession of the goods, he cannot get them back except in one class of cases. If the goods are in the hands of a carrier or other intermediary for transmission from the seller to the buyer, the seller may stop the goods in transit if the buyer becomes insolvent before the goods are actually delivered to him, even though title passed on delivery to the carrier. This right is exercised by notifying the carrier to hold the goods for the shipper since the buyer has become insolvent. After such notice has been given, the carrier cannot deliver the goods to the buyer. He must return them to the seller, who thereby reacquires his seller's lien which he can use to enforce payment of the price.

Seller's Rights When Title Has Not Passed—If the buyer refuses to take title to the goods when they are tendered to him, the seller has a right to recover damages. The amount of damages will be the difference between the value of the goods, which the seller still retains because the buyer refuses to take them, and the contract price which was promised. If the goods are worth as much as the price promised for them, the seller's damages will be only nominal, for he still has the goods and may sell them to some one else to as good advantage as he sold them originally. To fix the

damages which the seller may recover in a case of this kind, it is a common practice for the seller to sell the rejected goods in the open market and then recover from the buyer the difference between the proceeds of such sale and the original purchase price. Notice of a resale to fix damages should be given by the seller to the buyer, although such notice is not actually required.

In one special class of cases the seller may "force title into the buyer;" that is, by tendering the goods to the buyer, storing them, and notifying him that the goods are being held for him, the seller may treat the buyer as having bought the goods and may sue him for the purchase price. But the seller's right to do this is limited to cases where the goods are somewhat unique and thus could not be resold in the market at a reasonable price.

Remedies of the Buyer—We have already noted the nature of the remedies possessed by the buyer where the seller has committed a breach of an express or an implied warranty. Where the title to the goods has passed but the seller refuses to make delivery, the buyer can demand the goods upon tender of the price. If credit is given to the buyer, delivery and payment of the price are not concurrent conditions; consequently, the buyer can demand the goods without tendering the price. Where the title to the goods has not passed, the buyer's remedy is the same as that of any party to an executory contract, namely, to tender the price and sue for damages for breach of the contract. The amount of damages will generally be the difference be-

tween the reasonable value of the goods that should have been delivered and the purchase price.

Right of Inspection—A right which the buyer always has, in the absence of agreement to the contrary, is a right to inspect the goods to see that he is getting what he bargained for before he accepts the goods and pays the price. The seller must afford the buyer a reasonable opportunity to exercise this right of inspection at the place where delivery of the goods is to be made to the buyer, or, if they are to be shipped to the buyer, at the place of destination. If the goods fail to measure up to expectations, the buyer may reject them and sue the seller for breach of the contract. However, the buyer must reject all or none of the goods, for if he takes some he will be bound to pay the full price.

In many cases, the circumstances of the sale show that the buyer has given up his right of inspecting the goods before taking them and paying the price. It is not uncommon in modern business for the buyer to agree to pay the price without seeing what he is getting. A common example of this situation is the c.o.d. shipment. When goods are ordered sent c.o.d., the carrier requires payment before he will deliver the sealed package, and the buyer has no right to possession until the price has been paid. If the goods are not satisfactory, the buyer's redress is to sue the seller for breach of contract or for recovery of the price paid.

Another kind of bargain frequently made contains the phrase, "cash against bill of lading." This means that the buyer is to pay the price of the goods on receiv-

ing the bill of lading. Usually the bill of lading reaches the buyer before the goods arrive. Since by the terms of his bargain he has agreed to pay cash against the bill of lading, and since he cannot get the goods from the carrier without the bill of lading, he has no chance to inspect the goods before paying the price. If the goods prove not to be what he bargained for, he has a right to sue for breach of contract or for recovery of the price.

Effect of Fraud—Legal and Equitable Titles—To understand the effect of fraud upon a sale, we must distinguish between legal and equitable titles. A legal title is a full right of ownership against every one. The legal owner can take his goods wherever he finds them. An equitable title is a right to have the benefit of the goods or property; also, it frequently involves a right to have the legal title transferred to the equitable owner, making him full legal owner. An equitable title, however, is good only against the particular person who is subject to the equity and against any person who has acquired the property from such person, either without giving value or with knowledge of the equity. In other words, an equitable title is not good against a purchaser for value without notice. If A possesses the equitable title to goods, the legal title to which is in B, and B sells them to C, A can recover the goods from C only if C has not given value for them or if C, even though he has given value, knows of A's equity.

Fraudulent Sales—The most common case of equitable rights in sales arises in fraudulent sales.

Where a sale is induced by fraud on the part of the buyer, he gets the legal title to the goods, but the seller has an equitable title or right to get the goods back. Let us see how this works out. Suppose B procures goods from A by fraud and sells them to C. A cannot get the goods back from C if C paid value for them in good faith. If C did not pay value in good faith, then A may get the goods from C or from one who stands in the same position. If A can reach the goods before C secures delivery of them from B, A may replevy them or he may seize them if that is possible.

It is not possible to go into the various kinds of fraud that may be practised in the sale of goods, but there is one specific kind that arises so commonly as to deserve mention—that is, buying goods with the intention of not paying for them. Generally, in order to create a fraudulent sale, it is necessary that the fraudulent person shall have made some misrepresentation in words, but here is a case where, although it may be said there is a misrepresentation, it is not put into words. It is fair to assume that every buyer not only impliedly promises to pay but represents that it is his intention to pay for the goods, and perhaps that his financial condition is not so hopeless as to make the expectation utterly impossible of fulfilment. If the buyer either has a positive intention not to pay or is so hopelessly insolvent that any reasonable person would know that he could not pay for the goods, the transaction is fraudulent. The seller thus possesses an equity in the goods and may reclaim them from the buyer, even though the latter has acquired the legal title, or from

any other person to whom they may have been resold except from a bona fide purchaser.

Suppose the fraudulent buyer becomes bankrupt and the goods come into the hands of the buyer's trustee in bankruptcy. The trustee in bankruptcy is in legal effect the same person as the bankrupt himself; he is not a bona fide purchaser from the bankrupt, and thus the seller may reclaim the goods from the trustee in bankruptcy just as he might have done from the bankrupt before the appointment of a trustee.

CONDITIONAL SALES

Conditional Sales—A conditional sale is a transfer of the possession of personal property under an agreement to sell, the seller expressly retaining the title until some condition, usually payment of the full purchase price, has been performed by the buyer. Here we have possession and title divided. If it were not for the express agreement that title should remain in the seller, the delivery of the goods to the buyer, with his agreement to pay for them, would indicate a transfer of title to the buyer. The seller's purpose in making a conditional sale is to retain security for the price which the buyer cannot pay all at once and yet to allow the buyer the use of the goods.

Creditors of the buyer naturally suppose that the goods in his possession belong to him; hence to avoid deception, or possible deception, most states require that conditional sales be recorded so that creditors and others may have notice that the buyer is not the real

owner of the property, although he seems to be. But in some states such a record is not required at all, while in a few states conditional sales other than those of household furniture need not even be in writing except as required by the Statute of Frauds.

Rights of Purchasers from the Buyer—In a conditional sale the buyer thus appears to be the owner of the goods. However, since his ownership is merely ostensible and not real, a purchaser from the buyer cannot acquire title to the goods since the buyer has no title to convey to him. In states where recording of the conditional sale is required, failure to do so deprives the seller of such rights as he would otherwise possess against a purchaser from the buyer; that is, a bona fide purchaser for value will acquire a valid legal title. In states where no recording is required, such an innocent purchaser is not protected, and the seller may assert his title to the goods even against one who is a bona fide purchaser.

Loss of Goods Sold—In ordinary sales the risk of loss falls upon the person who has the title to the goods, since at the time of the loss he is the real owner. In conditional sales, all the elements of ownership, such as use and possession, except the bare legal title reside in the buyer. He may be regarded, and is regarded by the law, as the beneficial owner of the goods. For this reason the risk of loss lies with him once the goods have been delivered. If B buys a piano under a conditional sale and the piano is burned when $100 still remains to

be paid, B is bound by law to pay the $100, and he must also stand the loss of the piano.

Rights of the Seller—In a conditional sale, one remedy that the seller has as a matter of course is his right to sue for the purchase price, since the buyer has agreed to pay it. Upon payment of the price by the buyer or on the rendering of a judgment for the price in favor of the seller, title passes to the buyer. The very reason for making a conditional sale, however, is that the seller does not want to resort to the necessity of securing a judgment; he wants the goods as security for the payment of the purchase price. Therefore, the conditional sale agreement will usually provide that upon default by the buyer the seller may repossess himself of the goods.

Suppose a piano is sold under a conditional sale agreement for $500 payable in ten monthly instalments of $50, the title to pass only upon payment of the last instalment. Suppose the buyer, B, pays $450 and then defaults on the last instalment. May the seller then take back the piano and keep the $450 as well? Conditional sale agreements very often carry a provision to this effect, but the harshness of such a remedy upon the buyer has led many states to limit by legislation the seller's rights in this respect. In states where the Uniform Conditional Sales Act is in effect, the seller must sell the article upon reclaiming it and then return to the buyer any surplus over and above the balance due on the purchase price. In the absence of such legislation the seller may keep both the piano and the $450.

Legislation helps the seller in this fashion: Suppose that only $50 is paid by B and that B then defaults. S reclaims the piano and sells it for $350. May he recover the remaining $100 from B? Ordinarily he may not do so, having chosen to reclaim his property rather than sue the buyer for the purchase price; but under the Uniform Conditional Sales Act, he may recover the $100 deficit from B.

Consignments—A consignment is a bailment in which the consignee is an agent for the principal to sell the goods. It is like a conditional sale in that the person who has possession of the goods has not the title. It differs vitally from a conditional sale in that the consignee is not a debtor for the price but as agent is only required to turn over to the consignor the price of the goods when he has sold them. Until the goods are sold, the risk of loss is borne by the consignor and not, as in a conditional sale, by the person in possession of the goods. A conditional sale for the purpose of resale is somewhat analogous to a consignment; yet there is a definite distinction. In a conditional sale for the purpose of resale, the buyer is specifically empowered to pass title to a purchaser for value; in this respect it is like a consignment. However, the risk of loss until the goods are sold falls on the buyer, while in a consignment the risk of loss falls on the consignor.

Leases of Chattels—Somewhat like a conditional sale is a lease of a chattel with an option to purchase. One often finds a conditional sale agreement drawn in

the form of a lease with an option to purchase, the object being to avoid certain requirements of conditional sales such as the necessity for recording. But the courts will look behind the mere terms of the agreement to discover its substance and thus determine whether it is a conditional sale or a lease. Both are alike in that the person who has possession of the goods is not the legal owner. They differ in that the lessee. like a consignee, is not a debtor for the price of the goods; he is a debtor for rent. In a lease the risk of loss lies with the lessor and not, as in a conditional sale, with the buyer. When the option to purchase is exercised, the lessee becomes the beneficial owner. The risk of loss is his from that time on, and he is liable for the purchase price.

Chattel Mortgages—In a chattel mortgage, the owner of the property transfers the legal title to another person, who is known as the mortgagee, as security for the payment of a loan, the mortgagor remaining in possession of the property. Thus a chattel mortgage is very like a conditional sale; indeed it is often employed for the same purpose as a conditional sale. However, they differ in certain respects. In all states a chattel mortgage must be recorded to be effective against a bona fide purchaser from the mortgagor or against a creditor of the mortgagor. Upon default of the mortgagor, the mortgagee cannot simply take possession of the goods; he must foreclose on the property. That is, he must have the property sold under order of the court. If the proceeds of the sale are more than sufficient to pay the debt, the mortgagee must turn over any surplus

to the mortgagor; if the proceeds fail to satisfy the debt, he may hold the mortgagor for the deficit. In some states the mortgagee, by agreement, can himself exercise this power of selling the goods at a public sale without securing a court order. Like a conditional sale, the risk of loss rests on the mortgagor, the party in possession of the goods.

Mortgages of Future Goods—For the validity of a mortgage, it is essential that the goods be in existence at the time when the mortgage is made, since a title to goods not in existence at that time cannot be transferred. However, it is not uncommon for parties to seek to make mortgages on goods which at the time do not exist or are not specified, and this is especially true in regard to a stock of goods. Suppose A wants to borrow money on his stock of goods which is worth $25,000. Of course, he could mortgage the existing stock of goods without difficulty, but he wants to keep on doing business, and to do so he would have to sell the mortgaged stock of goods. No mortgagee would be willing to agree to such a plan unless security of equal value were substituted for any goods sold. An arrangement might be made whereby the mortgagor would have the power to sell existing goods in the ordinary course of business, provided he always kept on hand a stock of goods equal to that on hand at the time the mortgage was made, the idea being that as certain goods were released from the lien of the mortgage other goods of at least equal value should replace them.

While such an arrangement does not seem unrea-

sonable from a business standpoint, the law generally does not allow it validity except to a certain extent. It is valid between the parties so far as to give the mortgagee the power to take possession of the goods at any time. When he does take possession, the mortgage is valid against creditors as to the goods of which the mortgagee takes possession. The mortgagee may take possession at any time prior to the mortgagor's bankruptcy or at any time prior to actual seizure of the stock of goods on an attachment. Thus, the mortgagee has some security provided the mortgagor will give him an indication as to when it is wise to take possession. Of course, there is always a possibility that the mortgagee will not be able to take possession of the goods, and therefore this form of security is quite hazardous in most states. In some states, however, such a mortgage gives a right against goods afterwards acquired, and this right is superior to that of an attaching creditor or that of a trustee in bankruptcy, even though the mortgagee does not take possession.

Gifts Inter Vivos—Gifts inter vivos are the ordinary gifts made between living persons. When effectively made such gifts are irrevocable. Two things are required to make a gift effective, namely, the intent on the part of the donor to make a gift of particular property and the delivery of the property. The mere promise to give is not enough. Actual delivery of the article is necessary to put it out of the control of the donor. The delivery need not be made to the donee; it could be made to a third party for the donee. Where

the article is so bulky as to be incapable of manual delivery, symbolic delivery will suffice. Thus, the delivery of a key to a container would be sufficient delivery to effect a gift of the contents of the container. Delivery of a savings bank book, a bond, a stock certificate, or a life insurance policy would be sufficient delivery of the assets represented by these tangible choses in action. Delivery of the donor's personal check, however, would be insufficient to constitute a gift of the money represented by it unless the donee obtained payment of the check before it was revoked by the donor. Of course, the donor's death would operate as a revocation of the unpaid check. Where a delivery of the article cannot be made, either actually or symbolically, a gift may be made effective by a deed or by a promise under seal in those states where the seal has not lost its effect.

Gifts Causa Mortis—A gift causa mortis is like a gift inter vivos except that it is made by a donor in immediate apprehension of his death and upon the condition that the gift is revocable if the donor recovers from his illness or escapes the peril of death. If A, believing himself about to die, gives his watch to B, this may be either a gift inter vivos or a gift causa mortis. It is purely a question of fact as to what the donor intended. If it is a gift causa mortis and A recovers, he can reclaim the watch from B. Also, he can revoke the gift at any time before he dies, or if B dies before A, the title to the watch reverts to A. If it is a gift inter vivos, the gift is irrevocable since delivery has been made to B.

CHAPTER XIV

Real Property

AN estate is the term used to indicate an interest in land. There are three principal classes of estates in real property, namely, estate in fee simple, estate for life, and estate for years.

Estate in Fee Simple—An estate in fee simple represents complete ownership of the land. Such an estate may be one which its possessor has immediate enjoyment of or one which he will not enjoy until a lesser interest first comes to an end. This latter type is spoken of as a remainder or as a reversion.

Estate for Life—An estate for life represents an interest in land which a person holds only during his life. Following upon such an estate, there will be a remainder or a reversion in fee to some other person. Thus, if land is deeded to A for life, the estate that remains will be spoken of as a reversion in fee to the grantor. When A dies, there will be no lesser interest outstanding, and the grantor will again be in present enjoyment of a fee simple. A variation of the life estate is the estate for another person's life, as where land is granted to A for the life of B. Such an interest terminates only with the death of B.

Estate for Years—An estate or term for years is an interest granted for a definite period of time. The

time may be any length, such as one year or ninety-nine years. The estate ends, of course, with the termination of the period of time. Following upon such an estate, there will be remainders or reversions. Thus, the title to a particular tract of land might read as follows: to A for five years, to B for life, to C in fee. In other words, A would have a term for years; there would be a remainder to B for B's life, with a remainder to C in fee. Terms for years are commonly created by leases, the relationship of the parties to each other being that of landlord and tenant.

Dower and Curtesy—By the common law a wife, upon her husband's death, becomes entitled to a life estate in a one-third interest of all the lands of which he has been possessed since the date of his marriage. This interest of the wife, though not vesting until the husband's death, acts immediately to incumber the husband's title to land. Accordingly, where the common law rule of dower still prevails, a husband cannot give an unincumbered title to real estate unless his wife joins in the conveyance. Similarly, a husband is entitled at common law to a life interest in the lands of his deceased wife if they have had a child born alive. This is called the estate by curtesy. Its extent, it will be observed, is not the same as that of dower. The husband's life interest extends to all the lands of the wife, but it does not arise at all unless there is a child born alive. The wife's dower right, on the other hand, arises immediately on marriage. The rules of dower and curtesy have been changed by statute to a greater or lesser

extent in most states, but it is still almost universally important that a wife join in her husband's conveyance of real estate and that a husband join in a wife's conveyance of her real estate.

Easements—An easement is a right to use another man's land; it is a right which attaches to that land and is exercised for the benefit of neighboring land. Suppose that A, the owner of Redlands, grants to B, the owner of the neighboring plot of Windmere, a right of way across his land. This would be an easement, and it would burden Redlands for the benefit of Windmere. If A conveys Redlands to C, B will still retain his right of way. Easements may concern rights of way, rights of drainage, rights of support, and many other purposes. They may be created in two ways, either by deed or by adverse use. Uninterrupted use hostile to the owner over a period of time, commonly prescribed by statute as twenty years, would create an easement by adverse use.

CONVEYANCES AND CONTRACTS FOR THE SALE OF LAND

Method of Conveyancing—Real property differs from personal property in the formalities governing its transfer. Conveyances of interests in land must be in writing, and, except where seals have been abolished by statute, they must be executed under seal. Delivery is also essential to the validity of a conveyance. Conveyances are commonly made by one of two types of deeds, the warranty deed or the quit-claim deed. In

some states the customary form of conveyance is by warranty deed, while in others it is customary to convey by quit-claim deed.

The warranty deed carries with it three warranties or covenants: the covenant of title, the covenant against incumbrances, and the covenant of quiet enjoyment. By the first covenant, the grantor warrants that he has a title to the land in fee simple; by the second, that his title is free from incumbrances such as outstanding easements or mortgages; by the third, that the grantee will have undisturbed possession of the land and that the grantor will defend the grantee's title against persons who may claim to own the land. A quit-claim deed carries no warranties but simply conveys to the grantee whatever interest the grantor has in the land. Statutes in most states cover the question of conveyancing in an elaborate manner, prescribing the form in which deeds are to be executed and the nature of the covenants that are to be considered embodied in them, though not expressly stated. Some states prescribe limited types of covenants that are deemed to be embodied in a quit-claim deed.

Recording—All the states have some system for the recording of deeds in order to enable prospective purchasers to determine, by an examination of these public records, the nature of a party's interest in land. In order to make such records reliable for prospective purchasers, statutes provide that the failure to record a deed will operate to divest a grantee of his title as against a subsequent purchaser from the grantor. Thus,

if A grants Redlands to B, who fails to record his deed, and A later grants the same land to C who, having no notice of the prior conveyance to B, pays value for the land and records the deed, C can claim the ownership of Redlands as against B. Of course, B could bring a suit for damages against A, but A would in all probability have departed for parts unknown. The prompt recording of deeds is therefore of great importance.

Title Searches—Prospective purchasers very naturally are eager to know the nature of the prospective seller's title to the land. Therefore, an examination of records in the registry of deeds is made, and an abstract of the record, known as an abstract of title, is prepared. This abstract is then examined by an expert conveyancer in order to determine whether the seller actually owns what he purports to own. Title companies are now organized to do this type of work. In some of the large cities of the country, most of the title searching has passed out of the hands of lawyers into the hands of title companies, who can do the work much more cheaply than an ordinary lawyer. When lawyers are employed to make searches, a different lawyer may be employed at each sale of a particular piece of land; therefore, each lawyer makes a search back to the earliest deed. After a title company has made its search, the result of the search is on its records, and the next time it is called upon to search title on the same piece of property, the search is simply a continuation; that is, the company carries the search from the last time down to the present. The title company can thus make

its fee more reasonable than is possible for a lawyer.

Title companies also guarantee the title if the search they make convinces them that it is a satisfactory title. Guaranties are important in that they protect the purchaser against defects of title which cannot be discovered from an examination of the record. Suppose that A is desirous of buying Windmere and has the title examined. The title is reported free and clear, and the record shows that the grantor acquired title by conveyance from B three years before. A takes possession and pays the purchase price. Six months later the wife of B appears on the scene. When B conveyed, he stated in the deed that he was single; but the wife establishes the validity of her marriage to B and her husband's death. She is, of course, entitled to her dower rights, and A is obliged to make some kind of settlement with her. If his title is insured, A will be reimbursed by the title company for the loss which he sustains in having to pay the dower claim of B's wife.

The Torrens Law—The difficulty and cost of searching titles have led to the establishment in many states of a new system of land registration known as the Torrens system. Its purpose is to enable a person to ask for a court decree that shall confirm his title to land free and clear of all outstanding claims. Ordinarily, a court known as a land registration court conducts this work. It notifies all claimants of any right to the land to appear and establish their claims. If they appear, their claims are then determined; if they fail to appear, their claims are foreclosed, and they possess

only a right to compensation for this foreclosure from a fund in the custody of the court. Upon a finding that there are no valid claims established to the land, the court enters a decree to that effect. This decree, of itself, readily establishes a person's complete title to the land and makes a search of the records thereafter needless. Sales of the land may thus be easily made, and purchasers may rely with assurance upon these so-called Torrens titles.

Contracts to Convey Real Estate—What are the obligations of the seller and the buyer under a contract to convey real property? In the first place, it is the duty of the seller to convey a good or marketable title to the land. The buyer need not accept a title that is incumbered by some outstanding claim, such as a dower right or an easement, but every defect in title does not give the buyer a right to refuse to perform the contract. The defect in title may be removed before the time of performance, and if the nature of the defect is such that this is possible, the buyer can only give notice of the defect and request its removal. If the title of the seller is so defective that it cannot be cured, the buyer, upon discovering this, may immediately refuse to go on with the contract. If, before the time set for performance, the seller manifests an intent to repudiate the contract, as by selling the land to another, the buyer may at once notify the seller that he will not consider himself bound by the contract.

The second obligation of the seller relates to the nature of the deed which he must give the buyer. Of

course, the contract may expressly state that conveyance shall be by a special type of deed. Without an express stipulation to this effect, the seller must tender the type of deed which is the common mode of conveyancing in his particular community. This may mean only a quit-claim deed. Therefore, it is well for a purchaser, when contracting to purchase a piece of real property, to insert in the contract a clause to the effect that the seller agrees to convey by a sufficient warranty deed.

A third obligation is that the seller must not intentionally or negligently injure the premises before conveyance, such as by cutting down trees, opening mines, and so forth. This is termed committing waste.

The buyer's duty is simply to pay the price according to the terms of the contract. The obligations of the seller to convey and of the buyer to buy are concurrent, unless the contract expressly provides to the contrary. That is, in order to acquire a right against the seller, the buyer must tender payment as he demands the deed; the seller, in order to acquire a right against the buyer, must tender a proper deed when demanding payment. The obligation of either party to tender may be excused by circumstances showing that tender would be useless. Thus, if the buyer is insolvent, the seller need not tender a deed; if the seller has repudiated the contract, or committed waste to a material extent, or conveyed the premises to a third person, the buyer need not tender payment in order to acquire a right of action. However, if there is any doubt at all, the purchaser or the seller, as the case may be, should make a tender.

Default in Performance—The law regards more leniently a default in time in carrying out a contract for the sale of real estate than it does a similar default in the sale of personal property. In a sale of personal property, especially if the property is of such a character that it fluctuates rapidly in value, time is said to be "of the essence"; that is, the failure of either party to perform at or about the agreed time is fatal to his rights to enforce the contract. In the case of real estate, however, it is generally held that time is not "of the essence" of the contract, unless it is expressly so provided in the contract or unless the circumstances are such as to show that time is a matter of vital importance. Thus, neither party can regard a few days' delay in performance by the other as an excuse for not going on with the contract.

Destruction of the Premises—Where personal property, which the owner has contracted to sell, is destroyed accidentally, the loss falls upon the person who possesses title to the property at the time of destruction. If this rule were followed in contracts for the sale of real property, the loss would always fall upon the seller since he is the legal owner of the land until the deed is given. In most states, the rule with reference to contracts for the sale of real property is that loss through accident falls on the buyer. Thus, if A contracts to sell a certain piece of property and, between the time of the contract and the time for its performance, a house on the premises is burned down through no fault of A, A can still compel the buyer to

accept a deed of the land without the house and pay the full price, in the absence of special provisions in the contract to the contrary. In other states, the loss will not fall upon the buyer unless possession of the premises has been delivered to him under the contract.

Since the majority of states follow the rule that the risk of accidental loss rests upon the buyer, even though the seller still has possession as well as title, it is obviously of importance to the buyer that he insure the premises immediately upon contracting to buy. The insurance of the seller, unless transferred to the buyer at the time of sale with the company's assent, will not usually protect the buyer, for the seller's insurance only protects the seller's interest.

Remedies of Buyer and Seller—Both buyer and seller have the ordinary remedy of an action for damages for breach of contract. Another remedy, known as specific performance, is permitted in the case of contracts for the sale of land; that is, the court will actually compel one who has contracted to sell land to make a conveyance thereof on receiving the agreed price, and the court will similarly compel one who has contracted to buy land to pay the agreed price on receiving a deed of the premises. Specific performance of such contracts is granted on the theory that money damages are inadequate and that the nature of the situation is such that it is possible to compel the actual performance of the contract. In contracts for the sale of personal property, money damages are generally considered adequate, but certain contracts, such as a contract for the sale of

a painting or of a race horse, would probably be specifically enforced.

Sometimes the seller is unable fully to perform his agreed contract. He may not be able to give a title free from incumbrances, or he may have committed waste on the premises. Although the buyer need not carry out the contract unless he wishes, in such a case he may, if he chooses, have a conveyance decreed to him and an allowance deducted from the price commensurate with the injury caused by the incumbrance or the waste.

Not only will specific performance be granted against the seller, but if the seller, in violation of his contract, conveys the land to a third person who has notice of the contract or who does not give value in exchange for the land, the court will compel the grantee of the premises to convey them to the person who had the original contract to buy. However, if one who has agreed to sell the premises actually sells and conveys them to another who is a purchaser for value without notice of the prior contract, such a purchaser gets an indefeasible title, and the person having the prior contract to buy must resort, for his only relief, to an action for damages against the seller. For this reason, it is important to record a contract to buy or to sell. Such a record operates as notice to all the world, and no purchaser subsequent to the record will have the rights of a purchaser for value without notice.

Vendor's Lien—In some states a seller of land who has not been paid the price is entitled to what is called

a vendor's lien on the land. This enables him to compel a sale of the property to satisfy his claim for the purchase money, unless, before proceedings are brought to enforce the lien, the land has been conveyed to a purchaser for value without notice that the original vendor is still unpaid. In many states, however, the seller has no vendor's lien and must take a mortgage back for any unpaid portion of the purchase price if he desires security for its payment.

MORTGAGES

Nature of a Mortgage—A mortgage is a transfer of property to a creditor to secure a debt. The transferor is the mortgagor, and the creditor is the mortgagee. At common law the mortgagee was held to be the legal owner of the land. A mortgage was made by conveying the land outright to the mortgagee, with the provision that the conveyance should become invalid and the title should revert to the mortgagor upon payment of the named debt upon a given date. The mortgagee thus held legal title to the land, but the mortgagor had the right to reacquire the ownership by payment of the debt at maturity. The right of the mortgagor to redeem became known as his equity of redemption, and therefore the mortgagor was regarded as the equitable owner of the land.

Modern American Mortgages—At the present time in most states, a mortgage still remains fundamentally the same as under the early common law doc-

trines, both in the form of the instrument and in the legal conception of the rights of the parties. In a few states, the theory that the mortgagee has title to the property is no longer held, and he is considered to have only a lien which he may enforce if the debt is not paid. The difference in actual results under the two theories is less than might be supposed. Where the mortgagee is regarded as having the legal title, his power to make use of that title is limited to the purpose of securing payment of what is due him. On the other hand, where the mortgagee is regarded as having only a lien which is a legal right against the real estate, he enforces his claim by practically the same methods as he would use if he held the legal title to the real estate.

Equity of Redemption—By the terms of the mortgage, the mortgagor's right to redeem is ordinarily made dependent on payment of the debt on a fixed day, or on payment of instalments on fixed days. The day thus fixed in the mortgage is sometimes called the "law day." According to the terms of the instrument, the only way in which the mortgagor can be revested with title to the property is by complying with the express terms of the mortgage and by paying the debt on the law day. The result of the enforcement of this provision would be that if the debt were not paid exactly when it fell due, the mortgagee would remain the absolute owner of the mortgaged premises.

Courts of equity long ago limited the mortgagee's right, holding that, since the real object of the transaction is to secure a debt, if the mortgagee obtained his

debt and interest, he ought to be satisfied. Accordingly, if the mortgagor was in default in the payment of the debt, he was allowed to redeem the property by payment of the debt and interest to the time of tender. If the mortgagee refused to accept his debt and interest, the mortgagor could bring a suit in equity to redeem the property, and the court would order the reconveyance to him on payment of the debt and interest due.

The position taken by courts of equity in permitting the redemption might work a hardship on the mortgagee because he could never feel sure of his title to the property, however long the debt might remain unpaid. This difficulty was met by allowing the mortgagee to bring a suit to foreclose the debtor's right of redemption. (We speak of foreclosing a mortgage, but it is the debtor's right to redeem which is foreclosed.) When such a suit of foreclosure was brought, equity would fix a time within which the debtor might redeem the premises by paying the debt and interest, and the decree provided that if the debtor failed to pay within the period stated, his right of redemption would be forever foreclosed. At the present time, there are in practically all states statutory rules in regard to the foreclosure of mortgages, which we shall presently describe, but the fundamental nature of the mortgage transaction and the original remedies of redemption and foreclosure should be kept in mind.

Foreclosure of Real Estate Mortgages—According to the original theory of the law, the mortgagee became the absolute owner of the mortgaged premises

upon the failure of the mortgagor to pay the debt when due. The mortgagor still possessed his equity of redemption, and the mortgagee had to have this equity foreclosed by court action. Upon such a foreclosure, the mortgagee became an indefeasible owner of the property. This procedure was known as strict or common law foreclosure. However, it has been wholly abolished in most states, and judical foreclosure by sale has been substituted in its place. Under this latter procedure, the court, upon request by the mortgagee, sells the property and retains for the mortgagor everything above the mortgage debt and expenses.

Frequently the mortgage contains a provision giving the mortgagee the power of sale upon default in payment of the debt. This provision authorizes the mortgagee to sell the property without resorting to the usual foreclosure proceedings in court, but in the exercise of this power of sale, the mortgagee is acting not simply on his own behalf but as agent for the mortgagor in transferring title to the property. The proceeds are applied first to the payment of the debt, with interest and the expenses of the sale; any surplus is held by the mortgagee in trust for the mortgagor and must be paid over to the latter. The statutes of all states contain regulations in regard to the foreclosure of mortgages, and these regulations must be observed. Their aim generally is to protect the mortgagor from forfeiture of his property to any greater extent than is necessary to insure the payment of the mortgage debt. In any case of foreclosure, the local statute and practice must be consulted.

A Reconveyance Is Not Necessary on Payment of the Mortgage—On the theory of the common law, although the legal title to the property passed to the mortgagee, it was subject to a condition subsequent which would revest the title in the mortgagor if payment of the debt were made at maturity. By mere operation of law, therefore, payment of the mortgage when due revested title in the mortgagor without reconveyance. After a default, a subsequent payment would not be strictly a performance of the condition upon which the mortgage deed provided that title should revest. Accordingly, at common law a reconveyance was necessary, although now it is generally not required even in case of payment after default.

The Mortgagor Is Liable as a Debtor—Not only is the mortgaged land liable for payment of the debt, but the mortgagor is also personally liable for its payment. The fact that the debtor has given the mortgage does not in any way limit the rights of the mortgagee as an ordinary creditor. He may sue on the mortgage debt when it is due, in the same manner as if there were no mortgage. It is common for the mortgage debt to be represented by an instrument separate from the mortgage, as by a promissory note or a bond. The mortgagee has the option of foreclosing the mortgage as a means of collecting his claim or of securing a judgment on the debt. If he exercises the latter option, he will collect the judgment in the same way that an ordinary judgment creditor would. This rule has been changed by statute in a few states, the mortgagee being required

to realize from the mortgaged property what he can before seeking a personal judgment against the mortgagor for any deficiency which the proceeds of the property may leave. Such a personal judgment is called a deficiency judgment.

Rights of Mortgagor and Mortgagee in the Land—Even though the mortgagor is regarded by the law as no longer having the legal title to the premises, but only an equity of redemption, his interest is regarded as real estate and descends on his death according to the laws governing real estate. The mortgagee's interest, on the other hand, is regarded as personal property because the debt which the mortgage is intended to secure is personal property. Since the legal title to the real estate held by the mortgagee is held merely for security, it is an incident to the debt. The mortgagor's interest in the mortgaged property is subject to seizure on execution by his creditors, while the mortgagee's interest cannot be seized by his creditors. The mortgagee's creditors must reach his interest by means appropriate to realize upon the debt, not upon the land. The mortgagor's interest, being regarded as real estate, will give rise to the same estates of dower in favor of the wife of the deceased mortgagor, or curtesy in favor of the husband of the deceased mortgagor, as are allowed by the law in the case of real estate generally.

While in possession of the property, the mortgagor may deal with it in any way in which an owner may, except that he is not permitted to imperil the mortgagee's security by any kind of waste. Subject to the

mortgage, the mortgagor may lease, sell, or devise the land. He may collect the rents and profits and use them as his so long as he is in possession. However, where the mortgagee is regarded as having the legal title to the premises, he may eject the mortgagor at any time from possession, even though the mortgage is not due, unless prohibited by statute or by the express terms of the mortgage deed. In fact, he is usually so prohibited. Even when not so prohibited, it is not usually well for a mortgagee to take possession because, if he does so, he is bound to account for all profits actually received from the premises and also for all profits that might have been received. He becomes liable for any waste of the premises or for any failure to deal with them in a reasonably prudent manner.

Sale by Mortgagee or Mortgagor of Real Estate—Both the mortgagee and the mortgagor may assign their interests. In assigning his interest, the mortgagee is in legal contemplation doing two things: (1) assigning the debt; (2) assigning the title or lien which he holds on the mortgagor's real estate as security for the debt. The assignment of the debt is governed by the same principles that govern the assignment of choses in action generally. If the mortgaged debt is represented by a negotiable instrument, the instrument may be negotiated to the purchaser in the ordinary way and with the ordinary effects of such an instrument. If the mortgaged debt is not represented by a negotiable instrument, the assignment of the debt is an assignment of a chose in action.

Where the common law view that the mortgagee has the legal title still prevails, he can transfer the title to an assignee only by a deed executed with the same formalities as are necessary for the transfer of real estate. However, since the law recognizes the debt as the essential feature of the relationship between the mortgagor and the mortgagee and considers that the mortgaged estate is held merely as security for the debt, a valid assignment of the debt is held to make the assignee equitably entitled to the mortgaged property as security. In effect, one who obtains the mortgage debt will have the mortgaged property as security for that debt, even though the local law regards a mortgagee as having the legal title. Where the mortgagee is regarded as having merely a lien, the assignment of the debt involves a transfer of the lien.

If the mortgagor wishes to convey his interest, he transfers the estate by deed exactly as if it were unmortgaged, except that the deed contains the statement that the conveyance is subject to a specified mortgage, sometimes adding "which the grantee assumes and agrees to pay."

Assumption of Mortgage—From the seller's point of view, it is desirable that the grantee shall assume and agree to pay the mortgage, while from the buyer's viewpoint it is desirable that he shall buy the premises subject to the mortgage but without assuming it. In either event, the grantee receives the premises burdened by a mortgage, the amount of which is deducted from the consideration paid as the agreed

value of the premises; and in either event, if the debt is unpaid, the mortgagee can foreclose, and the grantee will have to pay the mortgage in order to save the premises.

The distinction is seriously important only when the mortgaged premises are worth less than the amount of the mortgage. In such a case, the mortgagee will be entitled to a deficiency judgment against the mortgagor, for the mortgagor was the original debtor and he cannot escape from his obligation to the mortgagee without the latter's assent. If the mortgagor is forced to pay, he cannot recover the amount from his grantee unless the latter assumed and agreed to pay the mortgage. However, if the grantee did make such an assumption and agreement, he will ultimately have to pay the deficiency.

If, without foreclosing on the property, the mortgagee should sue the mortgagor directly on the debt, the latter would be compelled to pay. In this event, the mortgagor, on paying the debt, would assume the position of mortgagee and would himself be enabled to foreclose the mortgage. If the property failed to realize enough to reimburse him for the payment of the debt, he would lose the deficiency unless the grantee had assumed and agreed to pay the mortgage.

Furthermore, the assumption of the mortgage by the grantee is a promise by him to pay the mortgage. As we have already seen, it creates a third party beneficiary contract with the mortgagee in the position of a creditor beneficiary. Thus, the mortgagee may sue the grantee directly for the payment of the mortgage

debt, or he may bring a foreclosure action and get a deficiency judgment against the grantee. Sometimes there is a succession of grantees, each of whom in turn, on buying the premises, assumes and agrees to pay the mortgage. In such a case, the mortgagee can recover from any one of the grantees so far as is necessary to satisfy his claim, but the ultimate liability will rest upon the last purchaser who has assumed the debt. As against a grantee who has not assumed the debt, the mortgagee has no rights. He can deprive such a purchaser of his land, so far as is necessary to collect the debt, but he cannot hold him personally liable.

Form of a Mortgage—A mortgage of real estate ordinarily contains the same covenants of warranty as a warranty deed of real estate. Covenants in regard to the payment of taxes by the mortgagor and the keeping of the premises insured for a certain amount are usual and important provisions. There is also commonly contained in a mortgage a power of sale, that is, an authority or agency given to the mortgagee to sell the premises free of the mortgagor's right of redemption in case of default of payment, or in case such default continues for a certain specified time. Where a mortgage still has its common law effect of transferring title to the mortgagee, it is essential that the mortgage should contain a provision that until default the mortgagor shall be entitled to the possession of the premises.

In all states printed forms of mortgages are ordinarily used. These forms are prepared with care to

suit the requirements of local law. Therefore, if the printed form is one which is prepared and sold for use in the state where the mortgaged land is situated, both parties may feel satisfied that the terms of the instrument are suitable to protect their rights.

Execution and Record of Mortgage—In all states, a mortgage of real estate must be executed with the same formality that is required for an ordinary deed of conveyance. As different forms are used in different states, it is always desirable to use the form of mortgage required for the state in which the land lies. It is, of course, important to ascertain whether or not a seal is necessary in that state. The instrument must ordinarily be acknowledged before a notary public or before a commissioner of deeds for the state in which the land lies. In every state there is a recording act by virtue of which unrecorded mortgages are made invalid against subsequent purchasers and sometimes against attaching creditors. Although, as between the parties, an unrecorded mortgage is as effective as one which is recorded, it is of vital importance to record every mortgage promptly in the registry of deeds in the county in which the land lies.

Special Cases—Where a mortgage is executed by an agent or by a corporation, it is essential that the agent or corporate officer have authority to act. In the case of a corporation, it is necessary both that the corporation have power to make the mortgage in question and that the particular officer or officers who at-

tempt to exercise the power are authorized to do so. The principles here involved are not different from those generally governing the acts of agents and corporations. The same may be said in regard to mortgages by husband or wife, by a partnership, or by trustees. In the case of mortgages executed by any such persons, however, it is necessary to take special precautions. Generally, a mortgage by the husband should also be executed by the wife, and vice versa. A mortgage by a partnership should be executed in the same form in which the title is held by the partnership. If the title is not held by all the partners, it is desirable that the other partners express their assent to the transaction, either in the mortgage itself or in a separate instrument executed with the same formality.

Deeds of Trust—In some states, what are called deeds of trust have been largely substituted for mortgages. The temptation to make such substitutions is greatest in jurisdictions which refuse to recognize the mortgagee as the legal owner of the premises. If the law denies the mortgagee this recognition, he can achieve the result that the mortgagor is no longer the legal owner of the premises by insisting, as a condition of his loan, that the premises shall be conveyed to a third person as trustee. The situation under a deed of trust is essentially the same as under a common law mortgage. In both cases the legal title is held merely to secure the debt, and the court will secure to the debtor all the value of the property which can be realized from its sale over and above the amount of the

debt. If the debt is paid, of course the debtor is entitled to the return of the security, whether it is real estate or personalty, and whether it is held directly by the creditor or by a third person as trustee.

Purchase Money Mortgages—In selling real estate, the buyer commonly does not himself possess enough money to pay the full purchase price. He may finance the transaction by securing a loan from a bank upon the agreement to give the bank a mortgage on the property, or the seller himself may be willing to take the balance of his money in the form of a promise by the buyer secured by a mortgage upon the property. Such a mortgage is known as a purchase money mortgage. The seller conveying the property to the buyer and at the same time receiving a portion of the purchase price and a mortgage securing the balance.

Second Mortgages—Under the common law theory of mortgage, the mortgagee acquires legal title to the property. Therefore, if the mortgagor wishes to borrow any more money on the land, he cannot give a similar mortgage to another person since he no longer has a legal title to convey. All he has left to mortgage is his equity of redemption, but on this he can take out a second mortgage. The second mortgagee thus does not acquire legal title to the land, but only the transfer of the mortgagor's equity of redemption to secure his debt. In other respects, the second mortgagee stands in much the same position as the first mortgagee. Although he cannot, upon default by the mortgagor, fore-

close upon the land, he can foreclose upon the mortgagor's right to redeem the equity conveyed to him. In some states, if the first mortgage is also due and unpaid, the second mortgagee can compel the first mortgagee to join him in a foreclosure proceeding, but the second mortgagee is generally sufficiently protected by being able to redeem the first mortgage himself.

The second mortgagee's position financially is much less secure than that of the first mortgagee, for the equity of redemption may be worthless. Suppose A mortgages land to B for $10,000 and then to C for $5,000. If A defaults upon the first mortgage and B brings a bill to foreclose the mortgage, C will be secured only if the land sells for $15,000 or more. If it sells for $18,000, the court will give B his $10,000, C his $5,000, and A the balance. But if it sells for only $10,000, C will get nothing from the land. Another important incident of the second mortgage is that upon discharge of the prior mortgage it automatically attains to the degree of a first mortgage. Thus, in the case supposed, if A pays off the mortgage to B and then defaults to C, C will be able to foreclose upon the land; he has more than the right to have an equity of redemption sold to pay his debt. Upon the same principles, third and even fourth mortgages may be given, each being subordinated to all the prior mortgages.

Substantially the same results are reached in states where the mortgagor retains the legal title to the property and the mortgagee gets a lien. The second mortgagee also possesses a lien, but his lien is inferior or junior to the first mortgagee's lien. The second mort-

gagee cannot enforce his lien to the detriment of the prior lien, but if the first mortgagee's lien is discharged by payment, the second mortgagee's lien becomes the first lien upon the property.

Mechanic's Lien—A mechanic's lien is a right given to a person who performs work or who furnishes materials in the construction of a building, in order to secure payment therefor from the owner's land and building. This right is not recognized at common law but is purely statutory in origin. The statutes of all the states provide in some manner for the mechanic's lien. Since the right exists solely by virtue of a statute, it becomes absolutely necessary to follow the exact provisions of the statute in order to create a lien. The statutes differ in character. Some limit the right to acquire mechanics' liens to workmen engaged in the construction of a house; some extend the right to workmen engaged in making repairs, alterations, improvements, or additions to an existing house.

Mechanic's Lien Statutes—In some important respects these statutes are quite similar. They give a lien not only to the contractor who has actually agreed with the owner to do the required work, but also to such workmen and subcontractors as the contractor may employ to work for him. These workmen have no contractual rights against the owner to compel payment of their claims. Their contractual rights lie against the contractor who employs them, but if the contractor fails to pay them, the workmen may file liens against the

building. Thus the owner will be compelled to pay the workmen in order to release his building from their claims. It is therefore common for an owner to require a contractor, before starting work, to execute a bond under which he and his sureties agree to pay all claims of workmen and materialmen. If the workmen then file mechanics' liens against the building, the owner can call upon the contractor and his sureties to pay these claims.

Filing of Claims—In order for mechanics' liens to be perfected, the workmen or materialmen must, within the time stipulated by the statute, file at the proper recording office statements of their claims and the facts upon which these claims are based. If no such statements are filed, no liens will arise. The purpose of this requirement of filing is to protect the owner and third parties. They may not know whether the workmen have been paid, but after the time has passed during which claims may be filed, they can assure themselves by an examination of the record that no outstanding claims will be asserted. Similarly, a third party desiring to purchase the premises can assure himself that he will receive a title free and clear of outstanding claims.

Enforcement of the Mechanic's Lien—The mechanic's lien is very like a mortgagee's right. It is a right against the building and not against the owner. Like a mortgagee, the possessor of a mechanic's lien can have the lien foreclosed by compelling a judicial sale of the premises and having his claims paid from the proceeds of the sale. Of course, the owner may pay

the claims to avoid a forced sale of his building. In such an event, he will attempt to compel the contractor, who was primarily responsible, to reimburse him for the loss. However, the possibility that the contractor may be financially irresponsible usually leads the owner to insist upon the execution of a bond by the contractor, as we have said, or else to provide that payments due to the contractor shall not be payable until the contractor has furnished proof that his workmen and materialmen have been paid. In this way the owner keeps back part of the contract price until he is assured that no mechanics' liens can be filed against his property.

Bonding of Mechanics' Liens—The owner of premises upon which mechanics' liens have been filed is often anxious to sell the property or to negotiate a mortgage loan upon it. Obviously, a third party dealing with the owner does not wish to have any rights which he may acquire in such property subordinated to the claims of the possessors of mechanics' liens against the property. These claims, as we have seen, are enforceable against the property no matter into whose hands it may come. To obviate this difficulty, the owner of the property, by furnishing proper security, customarily gets a bonding company to bond him against the mechanics' liens. Thus, third parties have the assurance that the bonding company will assume the risk of the non-payment of the mechanics' claims and are able to deal with the owner of the property relieved of the dangers arising from these outstanding claims.

CHAPTER XV

Estates and Trusts

WHEN an owner of property dies, what becomes of his estate? Who pays the bills? Who takes charge of his business affairs? What are the rules as to the division of his property? The first question a lawyer asks is, "Did the deceased die testate or intestate?" That is, did he or did he not leave a will? If he left a will, probably he named one or more executors to settle his estate, in which case such person or persons will take charge. If he did not appoint an executor in his will, an oversight which may occur, the probate court will appoint an administrator to dispose of his estate according to the will. On the other hand, if the man died intestate, it will be absolutely necessary for the court to appoint an administrator to dispose of his estate according to the Statute of Distribution governing the division of such estates.

Terms Defined—A testator is a man who makes a will; a testatrix is a woman who makes a will. A codicil is a supplement to a will, made and executed with the same formality as the original will; it becomes a part of the original will, adding to it or altering it, as the case may be. A devisee is a person who takes real property under a will. A legatee is one who takes personal property under a will. Real property passing under a will is called a devise; personal property passing under a will is known as a bequest.

Character of Property—It is very essential to distinguish carefully between the two kinds of property, real and personal, which the deceased leaves. Real property, as we have explained, consists of land and the buildings permanently attached to it; all other property is personal property, although it may relate to real property. Thus, a mortgage on land is personal property. The shares of stock in a corporation are personal property, although the corporation may be organized to engage exclusively in the ownership of real property. When a person dies leaving a will, his real property goes directly to the persons to whom he leaves it in the will. When a person dies intestate, his real property passes directly to his heirs at law, who are designated by statute. In neither case is any formality necessary, except that the will must be probated in order to vest the devisee of the testator with the title to the real property.

The situation in regard to personal property is quite different. When the deceased dies leaving a will, his executor immediately has title to all the personal property; if he dies intestate, the administrator will take title as soon as he has been appointed. The personal property is used first by the executor or administrator to pay the debts of the estate. The real property, whether a man dies testate or intestate, is never used to pay debts unless the personal property is insufficient.

Statutes of Distribution—All states possess laws governing the distribution of property left by a person who dies intestate. These laws differ in numerous details, and no general summary of them can be under-

taken here. They are usually very carefully framed and seek to carry out the general conceptions of who should share in the property of a deceased person. The interests of the wife and children are always preferred if the intestate leaves a widow and children; otherwise, close relatives are preferred to those more remote. As between persons similarly related, they share and share alike. The provisions of the statute of any particular state must be examined in order to understand the distribution of an estate upon the death of a person without a will.

ESSENTIAL FEATURES OF WILLS

Nature of a Will—The characteristics of a will are (1) that it makes a disposition of property which is to take effect after death, and (2) that prior thereto it is revocable. A moment's thought will convince any one that the making of a will must be carefully safeguarded. A will is rarely made public until after the testator dies; its validity is determined only after his death; the testator is dead when his property is distributed among the various claimants. For these reasons, statutes have prescribed certain formalities that must attend the making of a will, and unless they are complied with, the will is invalid.

The formalities are three in number: (1) The will must be in writing; (2) the will must be signed by the testator, and in many states the signature must be at the foot thereof; (3) the will must be attested by not less than two, usually three, witnesses. The attestation

of a will by witnesses has different requirements in different states. Some states merely require that the witnesses shall subscribe their names as bearing witness to the testator's signature. Other states require that the testator's signature shall be made in the presence of the witnesses, who consequently must be there at the time the testator signs, and that they must then sign their names. A fourth requirement necessary in some states is that the testator must publish his will, that is, announce to the witnesses that the document which he is signing and which they are attesting is his last will and testament.

Other Formalities—No particular form of writing is necessary. Probably the typewritten document is the most common form in use today. As a precaution against alteration, lawyers sometimes have the testator sign at the bottom of each typewritten page where the will is of several pages. Sometimes the document is fastened together with silk, the two ends of which are carried to the last page and imbedded in a wax seal. The testator should sign his name to the will, unless he is unable to do so from lack of education or feebleness, in which case the statute generally makes provision for another form of signing.

Witnesses—Two practices about witnesses should be observed. First, care should be used in their selection so that upon the testator's death they may be produced or their absence accounted for. Domestic servants or other persons who move from place to place

should not be selected, but persons who can be easily located if necessary will suffice. The witnesses should add their addresses to the signatures. In the second place, three witnesses should be employed. If a testator who lives in New York has two witnesses to his will, his will is valid so far as his real property in that state is concerned. However, if he also happens to own real property in a state where three witnesses are required, his will cannot pass title to the real property in that state; hence, so far as that state is concerned, he would die intestate. By having three witnesses, his will is good not only in New York but also in a state where three witnesses are required.

Peculiar Forms of Wills—Some states recognize the validity of holographic wills, others of nuncupative wills made under peculiar circumstances. A holographic or olographic will is a will which is wholly written in the testator's or testatrix's own hand. The statutes of a few states recognize these wills as valid without formal execution or attestation if they are wholly written, signed, and sealed by the testator's or testatrix's own hand. A nuncupative will is an oral will. While most wills must be in writing, in many jurisdictions the oral wills made by sailors at sea and soldiers in actual service are recognized as valid without being reduced to writing and without any specified number of witnesses. The difficulty of securing the materials with which to make a written will in the case of these two classes of people readily explains the reason for the exceptions.

Who May Make a Will—As a general rule, any person of sound mind and at least twenty-one years of age may make a will. In some states, a person eighteen years of age may make a will regarding personal property. Formerly a married woman could not make a valid will except in a few instances, but now the common law disability has been wholly or largely removed by statute. The statutes of the particular state in which the married woman resides, or in which her property is situated, should always be consulted to determine the law in this connection.

Revocation of Wills—A will may be revoked at any time before death. One of the methods ordinarily used to accomplish a revocation of a will is a subsequent writing. The testator may execute a later will and in express terms say, "I hereby revoke all former wills by me made." Even if such an expression is not put in the second will, the second will acts as a revocation provided its terms are wholly inconsistent with the former will. A will may also be revoked by mutilation, as by being burned, torn, or otherwise mutilated by the testator himself, or in his presence and at his direction. However, if not accompanied by an intent thereby to revoke it, the mutilation of the will is of no effect. Suppose a man thinks he is tearing up an old insurance policy, but he discovers later that because of poor eyesight he has torn up his will. This would not amount to a revocation of the will.

Sometimes changes in the circumstances and conditions of the testator's life will work a revocation. For

example, at common law marriage worked a revocation of a will. This has been changed in some states by statute. In many states also, the will of a testator executed prior to the birth of a child is revoked in toto when no provision for possible heirs is made in the will. However, these rules are not uniform in all states, and the local statutes should therefore be consulted.

Probate of Wills—Every state has a court for the settlement of decedents' estates. Such a court is variously named the probate court, the surrogates' court, the orphans' court, and the like. Before an executor named in a will has any authority to act, he must produce the will. After the proper proceeding has been had, the will is admitted to probate, and the executor may then qualify under it by giving the necessary bond. If the deceased dies intestate, the proper person applies to the probate court for the appointment of an administrator, and after a hearing, the court appoints the person entitled to receive letters of administration. The administrator qualifies by giving the necessary bond, after which he may proceed with the settlement of the estate.

Executors and Administrators—A testator may name any one in his will as an executor. In large cities, it is quite common for a trust company to be named as executor, because the facilities of such a company for handling estates render it more efficient than the average individual. However, if the testator is unwilling to place the sole care of his estate in the hands of

a trust company, he may name two executors, a trust company and some other person in whose judgment he has great confidence, who together act as executors. The fees which the executors receive are generally fixed by statute. If the deceased dies intestate, the letters of administration are granted by the court in accordance with a definite statute. While the law in the various states is not uniform, generally the priority of the right to administration, under the state statutes of distribution, is awarded to the person who is the next of kin.

Law Governing Wills—It frequently happens that a person dies owning real property located in a number of states, and it is almost certain that the laws governing the distribution of real property will vary in these different states. If the testator was a resident of Philadelphia, for example, his will probably was executed in accordance with the laws of Pennsylvania. The question arises as to whether such a will is valid to convey real property which he owns in New York, California, and Massachusetts. In so far as the will affects real property, the mode of execution and its validity are controlled by the law of the jurisdiction in which the real property is situated.

With regard to personal property, the validity and construction of the will are controlled by the law of the testator's domicile, that is, the state in which the testator's home was located. The question as to his domicile is sometimes quite difficult to determine and may require a court action. When a person dies intestate, the law governing the devolution of his real prop-

erty is the law of the state in which the property is situated, while the law governing the devolution of his personal property is the law of the state in which the testator had his domicile.

Claims against the Estate—An administrator or executor is bound to pay the debts of the deceased only to the extent of the assets of the estate. He cannot safely pay the legatees or the next of kin until an inventory of the estate has been made, the claims determined, and the balance remaining for distribution ascertained. This, of course, requires time, especially the determination of what claims are outstanding. Under modern statutes, the procedure is generally for the administrator or executor to publish a notice of his appointment so that the creditors may prefer their claims against the estate. If they fail to do so within a certain period fixed by law, the administrator or executor is entitled to distribute the estate. He will then be discharged, and the creditors who failed to prefer their claims will have no further rights against him. Some statutes go further and deny such creditors any rights against the distributees as well. It may happen that a creditor possesses against the estate a claim which will not fall due for several years. He must nevertheless present this claim, and the probate court will thereupon require the administrator to set aside enough from the estate to pay this claim when it falls due.

Distribution of the Estate—It often happens that a testator wills away more than he possesses. For ex-

ample, suppose T has $5,000 in the bank, a $1,000 liberty bond, and a house. By his will he gives his house to A, his liberty bond to B, $2,000 to C, and the remainder or residue of his property to D. His debts are $4,000. How shall the estate be divided? Obviously there is not enough for every one. The law has adopted specific rules for the determination of questions such as this. The general rule is that the assets of the deceased shall be applied to the payment of debts in the following order: (1) residuary estate, (2) general legacies, (3) specific legacies, (4) land. Specific legacies are bequests specifically referring to certain property owned by the testator, while general legacies are only bequests of property. A bequest of "my ten shares of United States Steel common" would be a specific legacy, while a bequest of "ten shares of United States Steel common" would be a general legacy even though the testator, at the time of the execution of his will and at his death, had ten shares of United States Steel common and no more. Thus, in the example supposed, A would get the house, B the liberty bond, C $1,000, and D nothing. If his debts were $5,500, C and D would get nothing; A would get the house; and B would get the surplus of $500 remaining after the liberty bond had been sold to satisfy the debts.

TRUSTS

Nature of a Trust—A trust is an obligation imposed by law upon a person holding legal title to property to manage such property and account for its pro-

ceeds to another. The person who holds the property and the legal title is called the trustee; the person for whom it is held is termed the beneficiary or "cestui que trust."

Creation of a Trust—A trust is created by a declaration of trust. The person who desires to create a trust, known as the settlor, expresses his intention that certain property shall be held in trust by himself or by another person for a named beneficiary. No formality is required for the declaration of a trust. Except as the Statute of Frauds may require, trusts may be either written or oral. The Statute of Frauds requires that all trusts of land shall be in writing. The most common method of creating a trust is by will, the testator appointing a trustee to manage a fund which he sets aside for the maintenance and support of a certain person or of a certain institution. In order for such a trust to be valid, the will must necessarily be valid.

Subject Matter of a Trust—Generally, whatever is property may be made the subject of a trust—land, personalty, choses in action, and so forth. Practically any person is capable of acting as a trustee. A corporation may so act if its charter gives it such power. The appointment, control, and removal of trustees lie within the control of the court. Courts generally see that no trust fails for want of a trustee. Thus, if a trustee refuses to serve or dies, the court will appoint a new trustee to take his place. Even where a testator fails to name any trustee but creates a trust by his will, the

court will on application by the beneficiary appoint a trustee to administer the trust.

Appointment of Trustees—A trust may be created between living persons without any appointment by the court. Thus, a real estate trust may be created by simply conveying property to trustees in trust for them to manage and pay the income to the beneficiaries. But in the appointment of trustees under wills, the intervention of the court in making the appointment is generally necessary. So also, where a disputed question as to a trusteeship arises, or where the appointment of a new trustee is necessary, the court takes jurisdiction, and any person interested in the trust may bring the matter into court.

Powers of a Trustee—A trustee holds the legal title to the trust property. He alone is capable of transferring that title, and any one who seeks a transfer of legal title must obtain it from the trustee. Since he possesses the power to transfer the legal title to the trust property, any purchaser from a trustee who takes such property in good faith and without notice of the trust acquires a valid legal title as against the equitable claims of the beneficiaries. However, the question of whether the exercise of such a power is a rightful one is important to any one who takes a conveyance from a trustee knowing that he is a trustee. He must assure himself that the trustee has power, under the terms of the trust, to sell the property in question. The power to sell must be found in the trust deed, either expressly

or impliedly, and the courts are slow to construe a power to sell by implication unless the character of a trust is such as to make the implication absolutely necessary. The trustee possesses no general power to sell except as found in the trust deed; he also has no power to pledge the property unless expressly given that power in the trust deed.

A trustee has power to make such contracts as are necessary to administer the trust. If he acts within his authority in making contracts, even though personally bound upon them, he has a right to reimburse himself from the trust estate. If a trustee enters into unauthorized contracts, he is still personally liable upon them, but he has no right to reimburse himself from the estate. The trustee may contract in such a way as to limit his personal liability and leave the creditor a right only against the trust estate, but to do this the trustee must use appropriate language, and merely describing himself as trustee does not reduce the individual liability under which a trustee is ordinarily placed.

Duties of a Trustee—The principal duty of a trustee concerns the care and custody of the property in his charge. The trustee is bound to keep the property invested in such a way as would reasonably be expected to produce an income. He may not, however, invest the property in speculative or hazardous undertakings. The statutes of most states specify the types of investments that may be made by trustees. Generally they include such secure investments as national, state, and municipal bonds, mortgages, and bonds of approved

public utilities. A few states allow the trustee to invest in high class common stocks.

Reasonable diligence in the discharge of his duty is all that is required of the trustee; if losses occur even though due diligence is exercised, the trustee is not responsible. Income from the trust fund must be dealt with according to the terms of the trust; that is, it must be distributed to the beneficiaries or accumulated as the case may be. At any time that it sees fit the court can order the trustee to make an accounting in order to determine whether his duties are being efficiently discharged. For mismanagement or fraud, the trustee is liable and will be deprived of his office by the court.

Trustee's Fiduciary Character—The legal relationship between the trustee and the beneficiary is a fiduciary one inasmuch as a great degree of confidence and trust is imposed in the trustee by the beneficiary. The trustee must disclose to the beneficiary full details as to the management of the trust. The trustee is not entitled to make any profit from the trust; his compensation is limited to those fees for management which the court may allow him or which may be provided for in the trust deed. If he has power to sell, the trustee cannot sell the trust property to himself or make contracts with himself, or in an indirect way make a profit out of the trust. He will be held accountable to the beneficiary for any profit earned by the trust fund.

Liabilities of Third Persons Dealing with Trustees—A third person who deals with a trustee knowing

him to be such will generally be protected if he acts in good faith. If he purchases from the trustee knowing that the trustee is acting in breach of the trust, the third person will also be liable to the beneficiary. If the trustee has a power to sell, the third person need not see to it at his peril that the trustee makes a proper application of the purchase money. Thus, a third person may buy from a trustee a negotiable instrument made out to the trustee as such, and he will not be liable even though the trustee spends the money so acquired for his own use.

The trustee should keep the trust money in a separate account, but without violating his trust he may deposit it in his own individual account. Therefore, a bank will not be liable for participating in a breach of trust if it credits negotiable paper payable to X, as trustee, to the individual account of X and allows him to draw against this account by individual checks. If the bank is aware that the trustee is misappropriating the trust funds which are held in his individual account, it is put on notice and can no longer safely accept checks payable to X, as trustee, for deposit in his individual account. The bank cannot take trust funds deposited in the individual account of the trustee in payment of an individual debt due to it from the trustee. In general, whenever a third person or a bank knows or should reasonably know that the trustee is misappropriating the trust funds, it will be liable for participating therein; but if the trustee is acting within his express or implied powers, the third person will be protected in the absence of suspicious circumstances.

Executors and Administrators—Because of the similarity of their positions, executors and administrators are commonly spoken of as trustees. In some respects their position and duties are very similar to those of ordinary trustees. They receive their appointment from the court and are accountable to it for the discharge of their duties. They may be removed by the court at any time for mismanagement or for fraud. Like trustees, they hold the legal title to the property in their charge and manage such property for the benefit of the legatees and distributees. Since the primary duty of an executor or an administrator is that of reducing the estate to a cash form and distributing it, he possesses the implied power to sell personal property, but he has no power to sell real estate unless the will expressly gives him that power or unless the court authorizes him to do so for the purpose of paying debts or legacies.

Unlike trustees, the duty of an executor or an administrator is not to invest the property but to convert and distribute it. He cannot invest the property unless authorized to do so by the court, although he may and is supposed to deposit personal property in a bank for safekeeping pending the time for its distribution. If he invests the property contrary to law, he will be liable to the beneficiary for any loss incurred thereby, and the beneficiary can also take all the profit should the investment prove profitable. Like a trustee, an executor or an administrator is under a fiduciary duty to the distributees and subject to the same stringent regulation that he must not make a profit out of the management of the estates in his charge.

CHAPTER XVI

Bills of Lading and Warehouse Receipts

MOST shipments of goods today are made under bills of lading. Upon its face a bill of lading is an acknowledgment by the carrier of the receipt of goods and a promise by him to deliver them to a designated consignee or to his order. It also contains provisions limiting the liability of the carrier for certain accidents to the goods in the course of transportation. The bill of lading thus serves three purposes.

In the first place, it is a receipt, being evidence of just what was shipped. It is important to the shipper as proof that the carrier received goods of the designated quantities and description in good order. It is important to the carrier as proof of the same thing, to prevent the shipper from claiming that he has shipped kinds or quantities of goods different from those described in the bill of lading.

The second purpose served by the bill of lading is that it furnishes evidence of the contract between the shipper and the carrier. As such, it contains stipulations that limit the liability of the carrier.

In the third place, the bill of lading is an order, when properly indorsed and surrendered, for the delivery of the goods to a designated person. It represents a documentary title to the goods; that is, it furnishes a means by which the goods may be dealt with while in transit and while in the possession of the carrier. One cannot speak of title passing or being retained on a shipment

of goods without referring to a bill of lading, because by means of a bill of lading title may be retained or transferred at will. This third aspect of the bill of lading is our primary concern.

Straight and Order Bills of Lading—Bills of lading are of two types. A straight or flat bill of lading is used when the goods are simply deliverable to a named person. An order bill of lading is used when the goods are deliverable to a named person or to his order. In most parts of the country where uniform bills of lading are in use, the straight bill is white while the order bill is yellow. These two types of bills of lading have important differences.

Carrier's Obligation to Deliver Goods—The difference between a straight and an order bill of lading springs from the obligation of the carrier with regard to them. If goods are shipped under an order bill of lading, the carrier cannot deliver the goods to any one except the holder of the bill of lading. An order bill of lading therefore has printed on it the provision that the bill itself must be surrendered before the goods will be delivered. If goods are shipped under a straight bill of lading, the carrier's obligation is simply to deliver the goods to the consignee named therein, with or without demanding a surrender of the bill of lading. This difference makes an order bill of lading valuable as something to lend money on, inasmuch as the carrier will hold the goods behind the bill of lading until the bill itself is presented and surrendered. Possession of

an order bill of lading thus gives its possessor a secure hold over the goods. The possessor of a straight bill of lading, on the other hand, has no such secure hold over the goods.

Use of Bill of Lading by Seller of Goods—One important purpose of a bill of lading is to secure the seller in his hold upon the goods until he receives the price. In an ordinary sale of goods, unless credit is given, the delivery of the goods and the payment of the price are concurrent conditions, delivery and payment taking place at the same time. When the parties are at a distance from each other, however, it is difficult to work out these concurrent conditions. If the seller ships the goods directly to the buyer, this is a mode of appropriation which passes the title to the goods to the buyer immediately upon shipment. The seller thus loses his hold on the goods, and if the buyer does not keep his agreement to pay promptly, the seller's only remedy is an action at law. On the other hand, the buyer does not want to pay in advance. By the use of a bill of lading, therefore, the seller is enabled to keep his hold on the goods until he receives the price, since the carrier will hold the goods until delivery and surrender of the bill of lading. Upon payment of the price, the buyer will get the bill of lading which will entitle him to claim the goods represented by it.

Seller's Use of Bill of Lading to Obtain a Loan—The transaction accompanying the sale of goods shipped under a bill of lading is usually more compli-

cated than one where the bill of lading is retained by the seller and is delivered to the buyer upon payment of the price. Usually the seller desires to secure payment for the goods as soon as possible, and he does this by borrowing from a bank on the security of the goods that he has shipped. He draws a draft on the buyer for the purchase price, takes the draft and bill of lading to his bank, and asks the bank to discount the draft on the security of the attached bill of lading. If his bank does this, it then sends the draft with the bill of lading attached to its correspondent bank in the city where the buyer resides. The correspondent bank presents the draft to the buyer to be honored. If the buyer honors it, that is, accepts it or pays it, he is given the bill of lading and thus is able to acquire the goods. In this transaction, the bank must rely primarily upon the security afforded by the bill of lading, for the buyer may repudiate the bargain, and the bank may not be able to recoup its outlay from the seller as the drawer of the draft. Consequently, it is of great importance to the bank to know with exactness the nature of the security afforded by the bill of lading.

Straight Bill to the Buyer—If the seller ships goods under a straight bill to the buyer, naming the buyer as consignee, the seller loses all hold on the goods. Under such a bill title passes upon shipment, and the carrier may deliver the goods to the buyer without demanding the surrender of the bill of lading. Such a bill of lading offers no security whatsoever to the seller of the goods.

Straight Bill to the Seller—If the seller ships goods under a straight bill of lading, naming himself as consignee, the carrier is then required to deliver the goods to the seller instead of to the buyer. Even though the buyer or a third person holds the bill of lading, he will not be entitled to get the goods since, under a straight bill, the goods are deliverable only to the named consignee. To enable the buyer or some third person to get the goods under such a bill, the seller would have to attach to it an order directing the carrier to deliver the goods to such a person and not to himself. But even if the seller had given such an order, he might demand the goods from the carrier without production of the bill of lading, unless the carrier knew of this outstanding order, so that when the third person later produced his bill of lading and his order, the carrier would no longer have the goods.

Straight Bills of Lading Give No Security—If we consider the position of a bank purchasing a draft with a bill of lading attached, we find that there is no security in a straight bill of lading. If the bill runs to the buyer, the buyer may get the goods without production of the bill, and the seller thus has no security. If the bill runs to the seller, the seller may get the goods similarly, and the buyer has no security. In short, possession of the bill gives no assurance that there are any goods behind it. Therefore, the first and fundamental rule to be followed by any bank which deals with bills of lading is never to lend on straight bills since they give no security.

Order Bills to the Buyer—If the seller ships goods to the buyer under an order bill of lading to the buyer's order, title to the goods passes to the buyer upon shipment, but the buyer cannot get the goods without producing the bill of lading. Therefore, by retaining the bill of lading, the seller retains control over the goods even though he has parted with title to them. Such a bill gives security to the seller and enables him to make the delivery of the goods and the payment of the price concurrent conditions. However, from the standpoint of a bank purchasing a draft on the buyer upon the security of such a bill of lading, this method has its drawbacks. Of course, so long as the bank retains the bill, no one else can get the goods; but if the buyer fails to honor the draft for any reason, the bank wants to be able to get the goods without any difficulty.

Since the bill is drawn to the buyer's order, it must be presented to the carrier with the buyer's indorsement on it before the carrier will deliver the goods. It would be possible for the bank or for the seller to get the goods without such an indorsement by proving to the carrier that the buyer had repudiated the bargain and had no more interest in the goods, but this would mean much unnecessary difficulty and would take up much time. For the bill of lading to afford a sound security, the holder should be able to realize upon it without unnecessary trouble in the event of default by the buyer.

Order Bills to the Seller—The most convenient method of issuing a bill of lading, and one which is in general use, is for the seller to take out the bill of lading

to his own order. He may then indorse it in blank and deliver it to the bank as security for the draft drawn on the buyer. If the draft is paid by the buyer on presentment at his city, he is given the bill of lading at once and is thus enabled to get the goods. On the other hand, if the buyer does not pay the draft on presentment, then the bank can realize on the security at once, if it wishes to, because it has a bill of lading in its hands indorsed by the consignee to whose order it is drawn. If the bank proceeds against the seller as the drawer of the draft, the latter may pay the draft, take up the bill of lading, and either realize upon the security or get the goods back since he has in his possession a bill of lading which runs to his own order.

Bills of Lading to "Order Notify"—A slight modification of the form of the bill of lading is generally made so as to let the buyer know when the goods arrive. When goods arrive at their destination, it is customary for railroads to notify the consignee; but if goods are consigned to the seller's order, the buyer receives no notice since his name does not appear upon the bill of lading. To avoid this difficulty there is generally put on the bill of lading, which is taken out to the seller's order when the goods are shipped, the words "Notify X Y," X Y being the prospective buyer of the goods. When the goods reach their destination, the carrier notifies X Y, who, upon learning that the goods have arrived, makes his plans accordingly. These bills of lading are often called "bills to order notify." The person who is to be notified is sometimes incorrectly called

the consignee. The consignee is the person to whom the goods are to be delivered and not the person to be notified; where a bill is to the seller's order, the goods are deliverable to the seller who is the consignee.

Wide Use of Bills of Lading—The use of bills of lading by sellers, in order to insure concurrent payment by the buyer and in order, with the aid of banks, to put themselves in funds while the goods are in transit, is an important part of business transactions today. It is by such means that the great crops of the country are moved. The cotton crop especially is moved almost wholly in this manner. The southern banks discount the drafts secured by bills of lading; these drafts are then rediscounted by the New York banks who draw on English bankers for a greater part of the price of the cotton.

Bills of Lading to Banker's Order—Bills of lading are used in foreign as well as in domestic commerce. Suppose a merchant in Boston wants to buy a cargo of goods from a seller in Germany, but he has not the ready money with which to do it. The seller in Europe does not know him and will not give him credit. Therefore, the merchant goes to a banker who has foreign correspondents and states his case. If his credit standing is good, his banker will say, "Order the goods from the man in Germany; tell him to make the bill of lading out to us and to draw on us or on our correspondents in Berlin. On receipt of the bill of lading naming us as consignee, we will pay, or cause to be paid, the bills of

exchange attached thereto for the price." In this way the goods are shipped directly to the banker who advances the purchase price of the goods. The banker then delivers the bill of lading, indorsed to the buyer, upon the buyer's making a settlement or giving him security for the advances that he has made.

Negotiable Character of Bills of Lading—To understand the nature of the risks attached to transactions concerning bills of lading, we must understand their negotiable characteristics and what is meant by negotiability. Ordinarily, one who buys a contract right gets no better right than is possessed by the person from whom he buys. Suppose that A owes B $100 but that B's right is subject on the part of A to a defense of fraud or mistake. If B sells his right to C, C's right against A will be subject to the same defense.

Though one who buys chattel property capable of delivery, like a horse or a book, does not get title if the person who sells it has no legal title to it, yet a purchaser in good faith and for value does get a good title to such property from a person who has the legal title but no equitable title. Thus, if B acquires A's horse by a fraudulent sale so that A can take the horse back from B, B has the legal title but not the equitable title to the horse. However, if B sells the horse to C, a bona fide purchaser for value, C gets an indefeasible title to the horse, and A has no rights against him. On the other hand, if B had stolen the horse from A, he would have no legal title to it. Hence, if B sold the horse to C, even though C were a purchaser for value and in

good faith, C would acquire absolutely no right to the possession of the horse.

Money and promissory notes possess an additional element of negotiability. If A makes a promissory note payable to B upon B's fraudulent representations, A has a defense to the note in the event he is sued by B. But if B indorses the note to C, a purchaser for value and in good faith, A's defense will not be available against C. Thus far negotiable instruments have the same characteristics as ordinary chattel property, but they possess an additional element of negotiability.

For example, suppose that after B has indorsed in blank the promissory note he received from A, it is stolen from him by X. Of course, B can get the note back from X, but if X sells the note to C who gives him value for it in ignorance of the fact that it has been stolen, C can claim the note against B, and he can also enforce the note against A. In such a case, the thief has power to pass a good title to a purchaser for value and without notice. In the case of money, as well as negotiable paper, a thief has power to transfer a good title to one who buys in ignorance of the fact that it has been stolen.

What elements of negotiability do bills of lading possess? Like promissory notes, they represent a right to the delivery of a thing, but goods rather than money. Like promissory notes, a purchaser of a bill of lading from one who has legal title but no equitable title is protected, provided that the bill is an order bill of lading. Thus, despite the fact that the person from whom an order bill of lading is bought obtained title

to it by fraud and could have had the bill of lading and the goods behind it taken away from him by the person defrauded, the purchaser in good faith and without notice will be protected. Straight bills of lading possess no elements of negotiability.

Another feature of negotiability that bills of lading possess is that the terms of the instrument are regarded as definitely showing the title. If the instrument is made to A's order, A has power to give a good title by indorsement, no matter what may have been the reason that the instrument was made payable to A. Even though it was agreed by the original parties that A should be merely an agent and should have no right to transfer the goods, a purchaser from A would be protected. Furthermore, if the instrument is made out on its face to the bearer or is indorsed in blank by the person to whom it is made out, any one acting in good faith may treat the holder as the owner and thus acquire a good title from him, although in fact the holder may not have a good title. Thus, if B indorses in blank a bill of lading to his order and X steals the bill and sells it to C who purchases it in good faith, C acquires a good title to the bill. These elements of negotiability which attach to bills of lading are recognized by the Uniform Bills of Lading Act, but in some states that have not adopted the statute, bills of lading only partially possess the characteristics of negotiability.

Indorsement of Bills of Lading—Order bills of lading must be indorsed by the consignee in order to be negotiated just as a promissory note requires in-

dorsement by the payee, but there is one difference between the indorsement of a promissory note and the indorsement of a bill of lading. The indorser of a bill of lading does not guarantee that the carrier will honor the bill of lading. If it turns out that the bill of lading is not honored by the carrier, the holder of an indorsed bill of lading cannot come back on the indorser in the same way that a holder of a promissory note can come back on the indorser if the maker fails to pay.

Trust Receipts—Bankers who hold bills of lading as security for drafts drawn on buyers engage in one form of doing business that often carries considerable risk. Frequently a banker allows the buyer to take the bill of lading indorsed in blank, in order to enable the buyer to enter the goods at the customs house, or to warehouse them, or even to sell the goods so that the buyer may obtain funds with which to discharge his debt to the banker. When the banker does this, he takes a trust receipt from the buyer in exchange for the indorsed bill of lading. Such a receipt states that the buyer has taken the bill of lading for a specified purpose, that he holds the goods as trustee for the banker who really owns them, and that any proceeds from the resale of the goods are to be turned over to the banker.

If the buyer is honest, no difficulty will arise, but if he is financially hard pressed and disposes of the bill of lading to a bona fide purchaser, in many jurisdictions the bona fide purchaser will be protected as against the banker. Therefore, before delivering the bill of lading

to the buyer, the banker should state on the face of the bill of lading that a trust receipt has been issued for a specified purpose. Then any purchaser of the bill of lading would have notice that it was held in trust; he would be aware of the terms of the trust and would be liable if he participated in a breach of the trust.

Change of Routing—Another risk is incurred where a bank holds for collection a draft with a bill of lading attached and allows the drawee to take possession of the bill of lading for the purpose of changing the routing of the shipment. The buyer may seek to do this if he sells the goods before he receives them and finds that he can save freight charges by changing the routing on the original bill of lading. Merely changing the destination of the goods does not do the bank any actual harm, except that where the goods are sent to a point somewhat distant from the original destination, the bank cannot conveniently get at them.

The real risk centers about the fact that the bank has allowed a person to have possession of a negotiable document. If the bank should fail to get the bill of lading back and the buyer should dispose of it to a bona fide purchaser, the bank would lose its security. If changing the routing involved the surrender of the old bill to the carrier and the issuance of a new bill, the bank would lose its security unless it actually obtained possession of the new bill. If the new bill should be issued with the purchaser named as the new consignee, the bank would have an inferior security even if it obtained possession of the new bill.

Accommodation Bills—It may be worth while to enumerate the risks which a purchaser or lender runs in dealing with order bills of lading, and to consider how far they are inherent in the nature of the business and how these risks may be obviated. The first risk is that the bill may have no goods behind it because it was originally issued without any goods. At points where there is a severe competition for freight, it has been quite a common practice for a carrier to accommodate a customer by issuing a bill of lading for goods before the goods are received.

When a seller in Chicago deals with a buyer in Boston, the seller normally would buy the goods, ship them, get a bill of lading, and obtain a loan from his bank on the strength of the bill of lading with draft drawn on the buyer attached. This method requires the seller to have money or credit in the first place in order to buy the goods to ship. It might be much more convenient for him to reverse the order, that is, to secure the money from the bank first, then buy the goods and ship them. To assist the seller, railroad agents have frequently enabled him to do just this. Relying on the seller's word that he will ship the goods on the next day, the railroad agent issues to him a bill of lading for the goods which the seller promises to ship. The seller goes to the bank, obtains the money on the bill of lading, then buys the goods and ships them.

Such bills are called accommodation bills, being issued by the railroad for the accommodation of the seller. The seller may carry on business in this way for some time without incurring any trouble, but sooner or

later the seller usually becomes bankrupt or fails to ship the goods after he has secured the bill of lading and the money. Then the bank finds on its hands a bill of lading for which no goods have ever been received by the carrier.

Fictitious Bills of Lading—In some cases the whole transaction may be a fraud. Instead of having the railroad agent issue an accommodation bill of lading, it may happen that the agent and the shipper, realizing how easy it is to obtain money on the basis of bills of lading, decide to make a few bills of lading fraudulently. The agent writes out what may be called fictitious bills of lading. They are not forgeries since they are drawn by a regularly authorized agent of the railroad and on the regular railroad form. What protection has any one who takes such a bill of lading? Is this case the same as one who takes an accommodation bill behind which there are no goods? If the carrier is liable to the holder of the bill, the holder will be amply protected inasmuch as carriers are generally financially responsible.

In an English case seventy-five years ago, it was held that the carrier was not liable on the ground that the carrier's agent was acting beyond the scope of his authority in signing a bill of lading for which no goods had been received. This decision, although much criticized, was followed in many of our states and by the Supreme Court of the United States. Later on, however, statutes were passed to enact a different rule which made the carrier liable. Such an act was the Federal

Bills of Lading Act, commonly known as the Pomerene Act, which applied to all bills of lading governing interstate shipments. Such a provision was also written into the Uniform Bills of Lading Act which would be applicable, in those states that have enacted it, to shipments intrastate in character. Finally, the Supreme Court of the United States overruled its earlier decision and decided that irrespective of statute the carrier ought to be held liable. Undoubtedly the state courts will eventually follow the decision of the Supreme Court, so that in most cases the holder will be able to sue the carrier for damages occasioned to him by the carrier's issuance of a fictitious or an accommodation bill of lading.

Inferior Quality or Kind of Goods behind Bill of Lading—A second difficulty sometimes encountered is that the goods behind the bill of lading may be different in quantity, quality, or kind from those specified in the bill. Such a difference may arise from one of two causes. It may be the result of negligent or intentional misdescription of the goods by the carrier, or it may be the result of fraud on the part of the shipper. Thus, if the bill of lading calls for 100 barrels of sugar and there are but 95 barrels, the misdescription is the carrier's fault, and in such a case the holder can sue the carrier. The carrier represented that it had received 100 barrels and promised to deliver 100 barrels; therefore it must do so or answer in damages.

Suppose that 100 barrels labeled and marked as barrels of sugar are delivered to the carrier and that

the carrier issues a bill of lading for so many barrels of sugar, but that when the purchaser of the bill of lading comes to realize upon his security, he finds that the barrels contain sand instead of sugar. In such a case, the fraudulent shipper will be liable, but fraudulent shippers usually disappear or are financially irresponsible. Will the carrier then be liable? The law holds that no liability will attach to the carrier. In the first place, the bill of lading says, "Contents and condition of contents unknown," so that the carrier has expressly guarded against promising or representing that the barrels really contain sugar. Even aside from this clause, the courts hold that the carrier is not liable for a concealed defect in the goods. The carrier's liability can attach only where the defect is patent and should have been observed at the time when the bill was issued, such as a defect in quantity, but even this is subject to exceptions as we shall see.

Shipper's Load and Count—In regard to one class of bills which are very common in some lines of trade and which are known as "shipper's load and count bills," there is an exception to the carrier's general liability for patent deficiencies of quality, quantity, or kind in the goods behind the bills. Where railroads build spur tracks to factories and run their empty cars to the factories, the shipper customarily loads the cars and himself writes out the bill of lading. The railroad agent then simply signs the bill of lading as presented to him by the shipper who has made out the whole bill except the signature, and the railroad agent conse-

quently does not know what goods are behind the bill. The railroad agent stamps across the bill of lading, "Shipper's load and count," which in substance means that the shipper has loaded the car and counted the contents, and that the railroad is therefore not responsible for the loading or counting of the goods or for their correspondence with the description given in the bill of lading.

An important principle to be kept in mind in regard to lending money on bills of lading is never to accept a shipper's load and count bill inasmuch as the carrier is released from all responsibility with respect to the goods. The lender would have to rely wholly on the honesty of the shipper. A number of years ago, some railroad companies promoted the idea that, inasmuch as the railroads are freed from liability on this form of bill, it would be a good thing to stamp all bills as shipper's load and count bills. The Pomerene Act sought to prevent this practice by forbidding the railroads to stamp the bills in such a fashion unless the shipper had himself actually loaded and counted the goods, and it provided that in case the bills were stamped in this fashion, the words should have no effect unless they truly represented the shipper's load and count.

Destruction of Goods in Transit—Difficulties with reference to bills of lading may arise after shipment. The goods may be absolutely destroyed in transit by any variety of causes, and the owner will necessarily lose his security unless, under the bill, the carrier

is responsible for that particular kind of loss. The provisions of the bill of lading govern in this respect and indicate for what type of loss the carrier is relieved of responsibility. Insuring the goods is one way for the shipper to protect himself, but insurance, to be effective, should cover destruction or depreciation in any form. Naturally, goods which are apt to depreciate in transit are not as acceptable security as goods which are more durable. A cargo of bananas is not as good security as a cargo of grain.

Lack of Title in Shipper—Another risk, which any one who takes a bill of lading runs, is lack of title to the goods in the shipper. The shipper may have stolen the goods, brought them to the carrier, and demanded and received an order bill of lading for them. Such a bill of lading appears to be like any good bill of lading, but the holder of the bill will not be able to keep the goods as against the true owner, nor will he be able to hold the carrier, for the carrier has done nothing wrong in issuing a bill of lading for goods that he has received. The carrier does not guarantee that the shipper is the true owner of the goods.

Spent Bills—A further risk may be that the bill of lading is what is known as a "spent bill." A spent bill is one where the goods have been delivered by the carrier at their destination but the carrier has not taken up the bill of lading. There is no means of telling from the face of a bill of lading whether or not the cargo has arrived and been released by the carrier. However, the

carrier is bound to take up an order bill of lading when he delivers the goods; consequently, under both the uniform and federal legislation, the carrier will be liable on the bill if it is left outstanding and is bought by a bona fide purchaser for value who supposes that the goods are still in transit.

This difficulty is not so apt to arise with spent bills as with what may be called partially spent bills. It is not uncommon for partial delivery to be made and the bill of lading still left in the hands of the holder. When all the goods have been delivered, the bill of lading is taken up, but when only part has been delivered, the carrier is not justified in demanding the surrender of the bill. To protect himself, the carrier should indorse on the bill of lading the fact that a part of the goods has been delivered, specifying the part. The bill of lading legislation requires the carrier to do this; if he fails to do so, he will be liable to the extent of his negligence to any purchaser of the bill of lading in good faith.

Lack of Title to Bills of Lading—Another risk, which one who buys or lends money on bills of lading runs, is the chance that the person from whom he takes a bill of lading may not have title to it. If the bill is indorsed in blank, a purchaser of the bill from such a person will, under the Pomerene Act and the Uniform Bills of Lading Act, get a valid title to the bill. However, if the bill is not indorsed in blank but specially, there may be a forged indorsement on the bill, and a genuine indorsement is essential for a valid transfer of the bill. Consequently, a purchaser of a bill who must trace his

title through a forged indorsement will not be protected, and the true owner of the bill may claim it from him.

Forged Bills of Lading—One final risk in regard to bills of lading is that the bill may be forged or altered. In practice this has proved the most serious risk of all, and numerous frauds involving large amounts have been perpetrated by the issuance of forged bills of lading. A person who obtains a forged bill of lading acquires no right against the carrier at all. His only claim lies against the person who sold him the forged bill of lading, but such a claim would undoubtedly be against a person who has absconded or who is financially irresponsible. A circumstance which renders forgery easier in the case of bills of lading than in the case of other valuable documents is the carelessness with which bills of lading are made out. Documents which represent a value of many thousands of dollars are scribbled hastily, sometimes in pencil, and on forms that are accessible to any one. The large number of forgeries that have taken place have called attention to this evil, and there is now a tendency to exercise more care in the making out of order bills of lading.

Devices to Prevent Forgery—In order to eliminate the risk of forgery, several devices have been suggested. One is that shippers shall pay the carrier an extra small fee for issuing order bills with the same precautions that are used in issuing stock certificates. The carrier would be expected to take the blank from a

numbered book and to punch and stamp it in such ways and with such countersigning that it would be very difficult to forge. Shippers have objected to this method because they dislike the extra expense; they want to continue to get their order bills of lading for nothing. Another proposal that has been made is to have some sort of central clearinghouse to which all order bills of lading shall be reported as they are issued, so that it will be known whether there is outstanding a document corresponding to one that is offered to a bank for security. This method is now in use to some extent.

Alteration of Bills of Lading—Alteration of a genuine bill may be as damaging as the out and out forgery of a new one. If a bill is fraudulently altered, the bill is worth just as much or just as little as it would have been worth had no alteration been made; that is, the alteration and not the bill itself is void. However, circumstances may alter this general rule.

Some years ago a man in Maryland who had always been in good repute, and who had a line of credit at his bank, kept bills of lading in his bank as security. He was allowed to change these bills of lading by substituting other bills for those held by the bank, always putting up sufficient collateral to cover what he took out. The railroad and steamship lines with which he did business neglected in some instances to take up the bills of lading which he presented for shipment. They habitually did not take up the straight bills, but this they were not required to do. They also failed to take up a number of order bills. When the man became

hard pressed, he took some of the old order bills and changed their dates. He then took some straight bills, changed their dates, added the words "or order" to the name of himself as consignee, and then indorsed them in blank. He took these altered bills to the bank and substituted them for genuine bills. When the fraud was discovered, the bank held about $100,000 worth of altered bills of lading. The carrier was held liable on the order bills, even though they had been altered, since the alteration had been made possible by the carrier's neglect of its duty in failing to take up these bills. But the bank could not recover on the straight bills since they were still straight bills despite the fact that the holder had written "or order" on them.

That particular case of fraud led to one change in the uniform bill of lading recommended by the Interstate Commerce Commission and in use for interstate shipments. The uniform order bill now has the words "or order" printed in front of the blank for the consignee's name, so that a straight bill cannot be made into an order bill by adding "or order." The difference in color between order and straight bills gives additional protection, but unfortunately foreign bills do not have this difference in color.

Attachment of Goods in Transit—Another risk which formerly existed has been eliminated by the Pomerene Act and the Uniform Bills of Lading Act. This was seizure of the goods in transit by attachment to satisfy some claim of a creditor of the owner. The effect of such an attachment was not quite clear at com-

mon law. The courts usually protected a purchaser of an order bill against later attachments by creditors of the former owner of the bill; but if the creditors of the former owner had attached the goods prior to the transfer of the bill, the attachment would generally be held to be good, although the purchaser of the bill knew nothing of the attachment when he bought the bill. Under the legislation now in force, there can be no attachment of the goods in transit if an order bill for them is outstanding. In order to make his attachment, the attaching creditor must succeed in having the bill surrendered or its negotiation enjoined.

Passage of Title as Affected by Bills of Lading—How is the passage of title to goods as between buyer and seller affected by the bill of lading? Ordinarily, the form of the bill of lading determines the answer to this question, since no better evidence of the intention of the parties is available than that which can be gathered from the form of the bill of lading. Thus, if goods are shipped upon a straight bill of lading which names the buyer as the consignee or upon an order bill to the buyer's order, title presumptively passes upon shipment to the buyer. However, it is possible, even in these cases, for title to remain in the seller until actual delivery of the goods, if there is an agreement to the effect that no title shall pass until delivery of the goods has been made at the point of destination. Similarly, if no goods have been ordered but the seller ships goods to the buyer under a straight bill naming the buyer as consignee, no title passes upon shipment.

Retention of Security Title—As we have said, the most common method of shipping goods under bills of lading is by taking out an order bill to the order of the seller. In such a transaction, title to the goods does not pass upon shipment, since the seller has expressly reserved the title to them as security for the payment of the price. Except for this reservation of title as security, the shipment is identical with any other which ordinarily passes title to the buyer upon shipment. Hence, because of this limited purpose for which the seller reserves title, the buyer is regarded as having all other rights of ownership in the goods from the time of shipment. If the goods are destroyed in transit under such circumstances as would relieve the carrier of liability, the loss falls on the buyer and not on the seller.

The buyer, moreover, is not entitled to the bill of lading until acceptance or payment of the attached draft. If the buyer acquires the bill of lading without performance of the conditions stipulated as to the draft, such action will not operate to transfer title to the buyer as against the seller, and the seller will prevail in any contest as to the ownership of the goods. However, if the buyer acquires the bill without performance of these stipulated conditions and then negotiates the bill to a third person, or sells the goods covered by the bill to a third person, the third person acquires title to the goods and will prevail as against the seller, no matter whether the bill is an order or a straight bill.

Acceptance or Payment of Attached Drafts—When a draft is attached to a bill of lading to be for-

warded to the buyer, the question often arises as to whether the buyer is entitled to the bill of lading upon payment or upon acceptance of the draft. Both the bank and the buyer must know what their respective obligations are with reference to the surrender of the bill of lading. The answer to this question depends upon the character of the attached draft. If the draft is payable on demand or at sight or within not more than three days thereafter, the buyer is entitled to the bill of lading only upon payment of the draft, and the bank should not surrender it without first receiving such payment. If the draft is a time draft, this fact indicates that it was not the intention of the seller to insist upon payment of the draft before the buyer should be entitled to the goods, since the seller has expressly given the buyer time for payment. Under such circumstances, the buyer is entitled to the bill of lading upon acceptance of the draft.

Warehouse Receipts—Warehouse receipts are similar in character to bills of lading, having the same effects as negotiable documents of title. Therefore, what has been said with reference to bills of lading is generally applicable to warehouse receipts. The rules governing their negotiation have been included in the Uniform Warehouse Receipts Act which is similar in its main provisions to the Uniform Bills of Lading Act. This uniform act has been adopted by practically all the states. In form, warehouse receipts may be order or straight receipts. Their provisions generally are simpler than those found in bills of lading because they

do not have so many special stipulations and conditions. The risks that one runs in dealing with warehouse receipts are the same in nature as the risks run in dealing with bills of lading. There is one respect in which the warehouse receipt gives the holder a better chance to protect himself than does the bill of lading. Warehouse receipts are generally used as collateral and for the purchase and sale of goods in the city where the goods are stored. It is therefore possible to telephone to the warehouseman, or otherwise to assure oneself of the existence of the goods, in a way that is not possible with bills of lading which cover goods in transit.

One other feature peculiar to warehouse receipts is worth consideration. A bill of lading does not, like a promissory note, have a date of maturity, and there is no particular way in which the purchaser can tell whether or not the bill of lading has finished its work. However, there is a time beyond which a bill of lading may be regarded as having completed its work; so much time may have elapsed since its issuance that the goods cannot conceivably be considered to be still in transit. This is less true of a warehouse receipt. The fact that a warehouse receipt is fairly old does not necessarily show that the document is not a perfectly good document and that the goods are not still behind it.

Open Receipts—There is one method of doing business with warehouse receipts which is entirely different from anything that takes place with bills of lading. It has been the subject of much criticism, however, and justly so. This is the practice of issuing open

receipts. In an open receipt, the warehouseman acknowledges that he has received a certain quantity of goods of a certain kind and that he will redeliver that quantity of the same goods, but not necessarily the identical goods that were deposited with him. It is contemplated that the depositor shall have the right to substitute, from time to time, other goods of like kind and quantity for the goods that were originally deposited.

Suppose a receipt has been issued for 100 bales of burlap, and the depositor who deals in burlap wants to use some of the bales that are in storage. He has pledged his warehouse receipt which was originally issued for the 100 bales, so he cannot surrender it. If he asks the warehouseman to let him take out twenty-five bales of the old burlap and substitute twenty-five bales of new burlap, the warehouseman may allow him to do so. This is an unsafe practice, for the goods proposed to be substituted may never be substituted at all or may be of a very inferior quality.

It is thus unwise for one who lends on warehouse receipts to permit the depositor and the warehouseman to agree to substitute goods covered by the receipt. Moreover, it is unsafe for the warehouseman. If the holder of the warehouse receipt has not consented to the substitution, the warehouseman will be liable to the holder of the receipt if the substituted goods turn out to be inferior to those which were originally deposited, unless the form of the warehouse receipt clearly shows that substitution is contemplated.

CHAPTER XVII

Torts and Crimes

IT is difficult, if not impossible, to give a satisfactory definition of the term tort. A tort consists of an injury done to a person through the violation of a duty that the law imposes in favor of such a person. The tort may consist of an injury to a person's property; to his physical person; to his reputation; to his family, business, or social relationships; or to other interests that the law recognizes as being susceptible to legal injury. The injury may be caused intentionally or carelessly. If A intentionally strikes B, he has committed a tort; if A carelessly drives over B in his automobile, he has committed a tort. In both instances A has violated a duty which he owes to B, namely, not to injure him intentionally or through careless disregard of the consequences of his own acts.

Crimes differ from torts chiefly in the fact that the injury caused is an injury to society at large. Every individual owes duties not only to other individual members of society but also to the public at large. A violation of the former duties makes him guilty of a tort; a violation of the latter makes him guilty of a crime. The duties which the individual owes to society are generally not so broad as those which he owes to its members. A crime usually involves a tort also. If A steals B's watch, A has committed not only the crime of larceny but also a tort of conversion. When A is prosecuted for the crime, the action will be brought by

the public at large, and it will be entitled in this fashion: "People of the State of Pennsylvania versus A," "Commonwealth of Massachusetts versus A," and so forth. The result of that action will be to subject A to punishment, either by fine or imprisonment or both. When A is sued by B for the tort, A will be forced to compensate B for the injury that he has done him, either by restoration of the thing or by payment of its value.

A few crimes do not also involve torts, such as suicide. Here the individual injured is the very person from whom compensation for the injury would be sought. On the other hand, many torts do not also constitute crimes. They are not of such a serious character as to constitute an injury to society for which the wrongdoer should be punished. The law is satisfied for the wrongdoer to compensate the party injured.

Jurisdiction over Torts and Crimes—Suits on contracts or on torts may generally be brought in any court which can get jurisdiction over the parties. If A takes B's watch in New York, B may sue A for the tort in California if a California court can serve A with process. A crime, on the other hand, can be prosecuted only in the state in which it takes place. If, in taking B's watch, A may be said to have committed larceny, only a New York court can punish A for the crime. If A flees from New York, another state will lend its legal processes to return A to the State of New York in order that that state may adequately punish him for the crime he has committed against the State of New York.

Consideration of Torts and Crimes—It is impossible for us to consider the subject of torts and crimes at length; hence, we shall content ourselves with a consideration of a few of those torts and crimes which are of a commercial nature inasmuch as they occur frequently in the ordinary course of business. The law which creates and defines torts is mainly common law, that is, the law which has been developed by the courts themselves and which is to be found in judicial opinions. The law of crimes, though having the same origin, is now mainly the creation of statutes. Most states have defined at length the various crimes, together with the punishments imposed for such crimes. Some states have developed separate criminal codes.

One characteristic of the criminal law in the United States deserves special notice, namely, that a crime may be committed against the Federal Government or against the state, sometimes against both. Using the mail to defraud is a federal crime and is punishable in the United States courts. Murder is commonly a state crime, since the Federal Government's powers to define crimes are limited to crimes concerned with the performance of those federal functions outlined in the Constitution of the United States. If one act constitutes a crime against both the state and the United States, the offender is punishable by both courts. The selling of intoxicating liquor formerly was a federal crime and in many instances also was a state crime.

Fraud or Deceit—The most important commercial tort is the tort of fraud or deceit. We have already

seen that fraud has the effect of making a contract unenforceable at the option of the defrauded party where the contract is still executory. If the contract has been executed, the defrauded party has a right to demand restitution of whatever goods he has given the other party. Fraud as a tort gives rise to an action for damages to compensate the defrauded party for the injury that the fraud may have caused him. If A fraudulently induces B to buy stock from C at $100 per share and the stock is worthless, B cannot rescind the contract of sale that he made with C since C was not guilty of any fraud. A did not enter into any contractual relationship with B; hence B can have no action against A based upon a contract. B's remedy against A for the loss occasioned by A's fraud thus lies in tort.

Essential Elements of Deceit—The tort of fraud is more commonly spoken of as the tort of deceit. It has five essential elements: (1) a false representation made to the plaintiff by the defendant, (2) knowledge that the representation was false, (3) the representation made with the intention that the plaintiff should act upon it, (4) belief by the plaintiff in the truth of the defendant's statement, (5) action by the plaintiff upon the statement to the plaintiff's damage. All these elements must co-exist in order for an action to be in tort.

Representation Must Be of Fact—The false representation must be as to a matter of fact. A statement of opinion will not constitute such a representation. If A says, "That stock is worth $200 a share," he

is making merely a statement of opinion. However, if he says that the stock was bought by X for $200 a share, he is making a statement of fact. A statement as to the future is not a statement of fact. If A says, "I will pay you $100 for this horse tomorrow," and A fails to pay the next day, there is simply a breach of promise, not fraud. But if A, at the time when he makes the statement, has no intention of paying, he is making a fraudulent statement; when he makes the statement, he represents that his present intention, which is a matter of fact, is to pay the next day, whereas his present intention is not to pay.

Representation Must Be Intentionally False—A careless or negligent statement which is false, but which its maker honestly believes to be true, cannot be the basis for a tort action for deceit. Suppose a banker should state that a certain stock had paid dividends during the past year, while as a matter of fact it had not. If the banker believed his statement to be true, relying on his own memory instead of looking up the records, his statement could not be the basis for a tort action. However, if the banker made the statement recklessly, realizing that he did not know whether it was true or false, his statement would be the basis for a tort action.

Communication to Plaintiff—The statement must have been communicated to the plaintiff with the intent that the plaintiff should act upon it. This does not necessarily mean that the defendant must have *actually intended* that the plaintiff should act upon the

statement, but simply that the statement must have been made in such a way that the defendant should have known that the plaintiff's ordinary reaction would be to rely upon the statement. Suppose that A sells sheep to B, intentionally representing that they are free from disease, whereas they are diseased. Suppose that B then sells the sheep to C, who, having heard of the statement that A made to B, buys the sheep relying upon A's statement. Although B would have had a cause for action against A, C has no right to an action in tort against A; the statement was not made to him.

Action by Plaintiff—The plaintiff must have relied upon the statement made by the defendant. If he made inquiries and found it to be untrue but nevertheless acted upon it, he could not recover damages from the defendant, for he could not then claim that he had relied upon the truth of the defendant's statement. However, it is not necessary that the plaintiff as a reasonable man should have known of the falsity of the defendant's statement. It is enough that he actually believed it and acted upon that belief. Of course, the fact that a particular statement made by a defendant was so preposterous as to be seemingly incapable of belief, although not negativing the fact that the plaintiff believed it, would be some evidence that the particular plaintiff did not actually believe it and rely upon it.

Libel and Slander—The tort of defamation, a term used to cover both libel and slander, springs from the

injury caused to one's reputation by a defamatory statement. Slander is oral defamation, while libel is written defamation. The distinction between the two is important because oral statements, if not slanderous per se, are not actionable unless the plaintiff can furnish proof of special damage resulting from such statements. All libelous statements are actionable without the necessity of showing special damage. Special damage means actual pecuniary loss resulting from the statements and not merely damage to reputation or mental suffering.

Statements that are slanderous per se are of three kinds: (1) those that impute the commission of a crime, (2) those that impute a loathsome disease to the plaintiff, and (3) those that disparage one in his trade or profession. The latter class is the most important. To call a lawyer a cheat, or to state that a business man is insolvent, or to impute a serious lack of capacity or want of integrity or misconduct to any one engaged in business would be slanderous per se. To state that a business man is intemperate would hardly be deemed actionable, while the same statement made of a clergyman would clearly be actionable.

Libelous statements are those which would tend to bring a person into hatred, contempt, or ridicule, or which would injure him in his office or calling.

Principles Common to Both Libel and Slander —To constitute either slander or libel there must be publication. This means that the statement must be uttered to or brought before the notice of some person other than the defamed person. To say to a business

man in his private office, with no one else present, that he has been dishonest and has stolen money would not be slander, nor would it be libel to write the same thing in a personal letter which the writer would have reasonable cause to believe would not be opened by any one other than the business man. If the business man should repeat the statement or read the letter to some one else, it would be he and not the other person who made the publication. However, if these statements were made to a third person or were written to a third person, they would then have been published and would be actionable.

Privilege—Certain clearly libelous or slanderous statements, though ordinarily actionable, may not be actionable because they were made upon a privileged occasion. In some cases the privilege is absolute; in others it is qualified by the requirement that the statement must have been made in good faith and with no intent to injure the person defamed. Statements made by a judge or by a witness in the course of judicial proceedings are absolutely privileged. Statements that are qualifiedly privileged are those made under circumstances where it is to the interest of the maker and of the recipient that the maker should disclose his full mind as to the character of a particular person. The most common example of this is a statement as to the character of a former employee made by his former employer to one who contemplates employing him and who requests information from the former employer. Another example would be a statement made by a com-

mercial credit agency regarding the credit standing of a business man to one who wished to extend him credit. Such statements must have been honestly made and not with the intention of injuring the party defamed. Comment upon the conduct of public men is privileged, provided it is made fairly and with an honest purpose.

Truth of Statements—The truth of the statements that may be made is a defense to an action for libel or slander. A person has no right to a false character, and to tell the truth about him does not constitute a tort.

CRIMES

Larceny and Embezzlement—The common law drew many varied and technical distinctions between the crime of larceny, which was a common law crime, and the crime of embezzlement, which was a statutory crime. It will not be worth our while to examine these distinctions. Some of them have disappeared with new legislation, although many of them still survive. Practically any person has a fairly accurate conception of what constitutes theft; yet it would be a very difficult matter in many cases to determine whether the theft constituted larceny or embezzlement. We can content ourselves with this definition, which is broad enough to cover both larceny and embezzlement, namely: Theft is the taking of property from another, without his consent and against his will, and with the intent to convert it to the use of the taker. There must be intention to appropriate the property of another. If A takes B's

horse from B's possession honestly believing that he is taking what already belongs to him, although the horse does not belong to A, there is no theft.

False Pretences—Perhaps the most common commercial crime is the acquisition of property through false pretences. This is a statutory crime. It does not constitute larceny, strictly speaking, because there is no taking of the property from the possession of the owner, but the owner is induced to give the property away because of the false representations that are made to him. The crime is very much like the tort of deceit. Its essential element is the intentional misrepresentation to another of an untrue fact for the purpose of procuring from that other person something of value, and the delivery of that thing upon the basis of the misrepresentation. One who intentionally sold sand for cement would be guilty of a crime, as would one who solicited money upon a misrepresentation that he was soliciting for a charitable society. A misrepresentation as to a man's state of mind would be sufficient to constitute a crime. A person who defrauded a seller of goods by promising to pay for them, when at the time he possessed the intention not to pay for them, would be guilty of false pretence.

"Cold Check" Laws—A common case of false pretence is the drawing of a check when the maker knows that he does not have in the bank sufficient funds to meet the check when presented for payment. Such conduct is usually made criminal by specific legislation,

but it would also come within the general category of false pretences. The statutes are usually framed so as to make it unlawful to obtain money or a thing of value by means of a check, in a case where the maker or drawer has not sufficient funds in or credit with the bank for the payment of the check. Under these statutes, the giving of a postdated check, where the maker does not have sufficient funds in the bank either at the time of drawing the check or when it is presented for payment, is usually not punishable. A postdated check is not a representation that the maker has sufficient funds in the bank; it is almost a representation to the contrary. It is a promise that the maker will have sufficient funds at a future time, and therefore a failure to have these funds becomes simply a breach of promise. However, if at the time the maker had no intention of having funds in the bank at a future time, it might well be possible to bring him within the general field covered by the crime of false pretences.

False Credit Statements—It is common in modern commercial practice for a merchant to make a detailed statement of his assets and liabilities in order to secure an extension of credit. Fraud is often committed as a result of false statements of this nature being made. Such false statements would seem to come within the statute which makes the obtaining of money or other things of value by false pretences a crime. However, many states have specific statutes which make false statements for the purpose of procuring an extension of credit a crime.

Forgery—Forgery consists of falsely making or altering, with an intent to defraud, a writing which apparently would have legal effect if the writing were genuine. Checks, negotiable instruments of all kinds, deeds, assignments of choses in action, wills, indorsements, railroad tickets, bills of lading, and warehouse receipts may all be forged, since each of these writings, if genuine, would serve as the foundation of another person's liability. The forgery need not be simply of the signature to be punishable; a forgery of a seal or a stamp is also punishable. If the writing has no legal effect, such as a letter of recommendation, it does not constitute a forgery.

Counterfeiting—Counterfeiting is a federal crime, made punishable by the laws of the United States. The Constitution expressly gives the United States Government the power to "coin money, regulate the value thereof, and of foreign coin," and "to provide for the punishment of counterfeiting the securities and current coin of the United States." By statute it is made an offense to utter or to possess, with an intent to sell or otherwise, coins or any obligation or other security made after the similitude of an obligation or other security issued under the authority of the United States. It is a criminal offense knowingly to possess instruments adapted and designed for the making of counterfeit coins. The utterance or circulation of counterfeit coin by one who knows it to be counterfeit is also criminal.

CHAPTER XVIII

Miscellaneous

WHAT is the nature of the relationship created when a customer deposits money in a bank? Suppose the bank should become insolvent. If the relationship between the bank and the depositor is that of bailor and bailee, or trustee and beneficiary, the customer's claim will have preference over the claims of the general creditors of the bank; he will be entitled to receive payment in full of his debt, while the general creditors will be entitled only to such dividends as may be available after bankruptcy proceedings. If the relationship is that of debtor and creditor, then upon insolvency the customer will share on equal terms with the general creditors. Suppose that the money is lost through accident and without fault on the part of the bank. If the customer is a bailee or a beneficiary, the bank will be excused from liability, while if the bank is a debtor, the loss of the particular money will not relieve the bank of its liability. Because of the differences resulting from the various possible relationships, it is important to analyze the character of any deposit made in a bank, in order to determine the liability of the institution.

The deposit may be one that simply establishes a debtor-creditor relationship or one that establishes a trustee-beneficiary relationship, depending upon the character of the deposit. The ordinary general deposit, where money is deposited in a checking account, creates

simply a debtor-creditor relationship. When the bank receives money for general deposit, it must be in such a condition that it will be able to carry out the purposes for which the deposit is made. It has no right to receive deposits of this nature when it knows at the time that it is insolvent. If it does nevertheless receive such a deposit when in an insolvent condition, a relationship of trustee-beneficiary is established, and the customer is entitled to the return of this deposit before any general creditors of the bank are paid.

Specific Deposits—Money which is not deposited for entry upon a general account but for some specified purpose, such as to pay a specified note, is known as a specific deposit. Whether such a deposit makes the bank merely a debtor or places it in the position of a trustee depends upon the character of the agreement under which the deposit is made. If the money is to be held separately by the bank, apart from its general funds, and is to be used by the bank only for a specific purpose, the bank stands in the position of a trustee of the money. On the other hand, if the bank is under no obligation to keep the sum separate from its own general funds but is to apply money from these funds for the purpose specified, the better view would be to regard the bank as a debtor under a contractual duty to apply money from its general funds to the purpose specified. Some states, however, regard the bank as being in the position of a trustee of all specific deposits irrespective of whether or not the money thus deposited is to be kept separate.

DEPOSITS FOR COLLECTION

Deposits for Collection—One of the most common deposits is the deposit by a customer of checks or promissory notes which are to be collected by the bank. Banks adopt different attitudes toward such deposits, some not permitting the customer to draw against them until they have been collected, others entering them "short" upon his account, others crediting them on the depositor's pass book but canceling the memorandum if the collection is not accomplished in due course. Occasionally, the course of business is such that the bank discounts this negotiable paper and actually purchases it outright, entering the purchase price to the credit of the depositor. In such a case, the relationship between the depositor and the bank is that of creditor and debtor. Otherwise, the bank simply acts as agent for the depositor. Many courts have hitherto been in conflict upon this question, but an attempt is now being made through the enactment of the Uniform Bank Collection Code to make the law uniform on this subject and establish the relationship as that of principal and agent.

Sometimes it is possible to settle the question without difficulty, due to the character of the indorsement upon the paper deposited for collection. Thus, if the paper is indorsed to a bank "for collection," "for collection and credit of," or "for deposit," the courts have no hesitancy in treating the indorsee for collection, that is, the bank, as an agent until collection. If the paper is indorsed generally, that is, simply in the name of

the depositor and without any restrictive words, there is a tendency on the part of many courts to regard the transaction like a purchase and therefore to regard the bank as a debtor. The Uniform Bank Collection Code, however, treats the bank as agent whether or not the indorsement is restrictive. However, in the absence of some express indication that a sale was intended, most courts treat the bank as a trustee until collection.

Position of Bank after Collection—After collection the position of the bank is generally that of a debtor. The bank is not required to hold in a separate fund the money that it has collected; it is supposed simply to carry the amount of the collection to the general credit of the depositor and to pay him on demand from its general funds. This is true no matter what the original character of the deposit was, that is, whether the paper originally deposited was indorsed generally or restrictively. The fact that the bank may charge a small fee for collection does not alter the situation; it remains a debtor for the amount collected after deduction of the fee for collection. A few states, however, tend to regard the bank as remaining in the position of an agent upon the basis of minor variations in this transaction, such as the charging of a collection fee or the indorsement of the paper "for collection and remittance to" the depositor.

Collection by Correspondent Bank—The situation becomes quite complicated when the collection of the paper is made through a correspondent bank. Sup-

pose A deposits a bill for collection in the X bank, and the X bank forwards the bill to the Y bank for collection from the maker or drawer. The X bank as agent originally held the bill in trust for A, but it parted with the bill to the Y bank, which thereupon held the bill in trust for the X bank. The X bank thus holds its right against the Y bank for the benefit of A. If, before collection, either the Y bank or the X bank becomes insolvent, what are the rights of A? If the Y bank becomes insolvent, the X bank will still be entitled to the bill, and it will hold this right for the benefit of A, so that A will not lose. If the X bank becomes insolvent, its general creditors cannot reach the thing that it holds in trust for A, and this thing is its right against the Y bank. Consequently, A again will not lose, for A will be entitled to claim the bill from the Y bank. Therefore, if either the depositing bank or the correspondent bank becomes insolvent before collection, the depositor is not injured, and he can reclaim the paper that he deposited for collection.

Position of Correspondent Bank after Collection—Suppose that the Y bank collects the money due upon the bill. From that moment the Y bank becomes a debtor to the X bank for the sum collected, and the X bank holds this claim against the Y bank in trust for A. If the X bank now fails, the claim for which it is trustee cannot be touched by its general creditors but belongs to A. A therefore will not lose, and he can proceed directly against the Y bank for the sum that it has collected. Suppose that the Y bank fails after collec-

tion of the bill. As the Y bank is simply a debtor for the sum to the X bank, the X bank has no rights that are superior to those of any other general creditor of the Y bank and consequently can claim only such share from the Y bank as a general creditor is entitled to. That claim and the sum realized upon it the X bank will of course hold for A. But can A claim anything more from the X bank? On this question there is a difference of opinion among the various states and local statutes should be consulted.

Ordinarily, it is true that an agent is not responsible to his principal for a loss of or for a decrease in the value of funds intrusted to him where this loss or decrease has been due to circumstances for which he was not responsible. If we assume that the X bank was not negligent in selecting the Y bank as a correspondent, the insolvency of the latter, which brought about a loss in the value of the note was not due to the fault of the X bank. Consequently the X bank as an agent would be under no liability for this loss, and A would be entitled only to what the X bank succeeded in obtaining from the Y bank. This is the result that is reached in some states and is known as the Massachusetts rule. It is also the result that would be reached under the provisions of the Uniform Bank Collection Code.

Other states, however, follow the so-called New York rule which makes the original depositing bank liable on the theory that it is held to guarantee the solvency of its correspondents. In states that follow the New York rule, the banks usually contract themselves out of such liability by incorporating provisions to this

effect in the deposit slips furnished to and signed by customers when making deposits for collection. The same divergent view is taken as to the liability of the X bank where the Y bank is responsible for a loss because of its negligence in collecting the bill.

Remittances by the Correspondent Bank—After the Y bank collects the bill, it occupies the position of a debtor to the X bank, and the X bank holds this claim for the benefit of A. The next step is for the Y bank to remit to the X bank the money that it has collected. Upon receipt of this money, the X bank, ceasing to act as an agent, occupies the position of a debtor to A, and the Y bank drops out of the transaction. If the X bank then fails, A will simply be entitled to share with the general creditors of the X bank. If the X bank were insolvent at the time the money was collected by the Y bank, it would have no right to receive the money from the Y bank. If it nevertheless did receive the money, it would be in the position of any bank that receives a deposit after it has become insolvent, namely, that of a trustee to the depositor.

Until the Y bank remits the money to the X bank, therefore, the X bank remains a trustee and does not become a debtor to A. A settlement of accounts between the X bank and the Y bank is equivalent to a remittance, and after such a settlement the X bank becomes a debtor to A. However, if the Y bank merely credits the account of the X bank with the sum collected, this act is not equivalent to an actual remittance or to a settlement of accounts. Even after such credit-

ing, the X bank still retains its position as trustee of the claim which it possesses against the Y bank.

Deposits for Payment—A deposit for payment, as we have seen, ordinarily creates simply a debtor-creditor relationship unless the sum is to be kept separate from the general funds of the bank. However, difficult problems arise where a correspondent bank enters the transaction. Suppose A makes a deposit in the X bank to meet the payment due on a note held by B, and the X bank forwards that sum to its correspondent, the Y bank, in order that the Y bank may pay B. Upon receipt of the money, the X bank stands in the position of a debtor to A. When the sum has been forwarded to the Y bank, the Y bank becomes a debtor to the X bank, and the X bank holds this claim against the Y bank for the benefit of A, standing in the position of a trustee or agent for A. If the X bank fails, its general creditors cannot avail themselves of its claim against the Y bank since the X bank holds this claim in trust for A; consequently A will not lose. If the Y bank fails, A will be able to recover only on the same basis as a general creditor of the Y bank, unless the X bank can be held to guarantee the solvency of its correspondent.

In transactions of this nature, it is more common for the X bank simply to credit the Y bank rather than to remit the money directly to the latter. Where the Y bank is simply credited, the X bank has no claim against the Y bank for any money; consequently, the X bank does not possess any specific thing which it can be regarded as holding in trust for A. The X bank thus

remains simply a debtor to A. If it fails, A will have to come in with the general creditors. On the other hand, if the Y bank fails, A will not lose, inasmuch as by crediting the Y bank the X bank has not changed its position of debtor to A. Consequently, any loss of sums held by the X bank as debtor will not absolve it from its liability to pay the debt in full.

SURETYSHIP AND GUARANTY

Suretyship and Guaranty—Suretyship has been defined as an accessory agreement by which one binds himself for another who is already bound. A surety is a person who is bound to perform any act that his principal is bound to perform in the event that his principal fails to perform as agreed. Where there are several sureties the parties are known as co-sureties. The distinction between a contract of suretyship and a contract of guaranty is not altogether clear. The terms are sometimes used synonymously. Both the surety and the guarantor are persons who are bound for the performance of an obligation by a third person. The surety is bound to exactly the same obligation as the principal debtor, while the guarantor is bound only when the principal debtor has failed to perform and the guarantor is notified of this fact.

If S is surety to P upon an obligation to pay C $100, C can immediately sue S when the debt remains unpaid at maturity. If S is simply a guarantor, C must first demand payment from P and can sue S only after S has been informed of P's default. In some states, where

S is a surety, C can sue S and P together, while if S is simply a guarantor, C must sue them separately. The general principles applicable to contracts of guaranty and suretyship are similar. In order to determine whether a particular contract is that of suretyship or of guaranty, the nature of the agreement must be thoroughly scrutinized. Irrespective of whether or not the parties used the term "guarantee," the nature of the agreement rather than the term used will determine the question.

Qualification of a Surety—A surety is to be distinguished from an indorser in that the undertaking of a surety is absolute, while that of an indorser is conditional. An indorser promises that upon due presentment of the instrument it shall be accepted or paid, as the case may be, and that if it is dishonored and the necesssary proceedings on dishonor are duly taken, he will pay the sum due upon the instrument. To charge an indorser, the instrument must be duly protested and the indorser must be notified, else he will be discharged. Indorsers sometimes write upon a note words to this effect, "I hereby guarantee the payment of this note." They are thereupon liable as guarantors, so that, even though the holder may not have given the proper notice to hold them as indorsers, they will be liable if the holder has sought to obtain payment from the maker and has informed the guarantor of the maker's default.

Capacity to Act as Surety—Ordinarily, the relationship of principal and surety is entered into under

the terms of a contract. Persons who possess contractual capacity thus possess the power to become sureties. An infant may become a surety, but his contract to do so is voidable at his election as any ordinary infant's contract would be. In a few states, statutes prohibit married women from becoming sureties, although married women may possess a general contractual capacity. Especially is this true of a contract by a married woman to act as surety for her husband; such a contract is generally prohibited and is therefore invalid. Corporations possess the power to become sureties where such a contract falls within the express or implied powers of the corporation as set forth in its charter.

The Statute of Frauds — The Statute of Frauds requires that all promises "to answer for the debt, default, or miscarriage of another person" must be in writing to be enforceable. Since contracts of suretyship or guaranty are promises of this nature, they must be in writing to conform to the provision of the statute. There are a number of technical exceptions to this general rule, the exceptions varying in the different states. While we cannot detail them here, the fact that there are exceptions should be kept in mind and the statutes of the states consulted for particulars.

Suretyship Liability—The general extent of the surety's liability is measured by the liability that his principal assumes. If no cause of action can be brought against the principal, the surety is also relieved of liability. Suppose that S became surety on an obligation

by P to pay C $1,000, but that the promise made by P was usurious and consequently unenforceable against P. C could not enforce the obligation to pay against S. This rule, however, is subject to many exceptions. The state courts are widely divided upon the question of whether the surety can avail himself of the defense of fraud which is open to the principal. If P is fraudulently induced to enter into a contract, he can at his election avoid his obligation to pay, but it is questionable whether S can avail himself of the election which his principal possesses. Infancy of the principal is no defense to the surety. If P were an infant, he could refuse to pay, but S could not avail himself of such a defense. Bankruptcy of the principal is also no defense to the surety, as the United States Bankruptcy Act expressly states.

Individual Sureties and Surety Companies—Until fairly recently the surety company was unknown. Sureties were individuals who ordinarily assumed the surety obligation without any pecuniary compensation. Because of this fact, the courts had a tendency to treat the surety lightly and laid down the rule that the liability of the surety would be strictly construed. Consequently, any doubts as to whether the surety was liable under a particular set of circumstances would be resolved in favor of the surety. The attitude of the courts changed with the rise of surety companies, which, under their charters of incorporation, are authorized to guarantee the performance of contracts and to execute all manner of bonds, and which demand a price for becom-

ing sureties. This striking difference, namely, that the surety company offered its services for a price which would net the company a profit upon its various undertakings, materially altered the conception of the surety and did away with the old reason for treating the surety lightly. The courts realized that the creditor should be entitled to the indemnity which he had reasonable grounds for expecting. Consequently, the rule now in existence is simply that the contract of suretyship be reasonably interpreted, taking into consideration the needs of the creditor for realizing upon his expected indemnity and the insistence of the surety that his obligation shall be measured only by the terms of the contract.

Variation of the Principal's Obligation as a Discharge of the Surety—Since the surety has engaged to be responsible for the performance of the principal's obligation, any variation of the principal's obligation will operate to relieve the surety of his liability. The surety has undertaken to assume a particular risk; therefore, the principal must not do anything which will increase that risk to the injury of the surety or which will be inconsistent with the surety's rights. If the principal and creditor alter the contract or extend the time of payment, the surety is released from liability unless he is consulted and gives his assent to such changes. Under the application of this rule, an agreement between the principal and the creditor, whereby the former is given an extension of time for the payment or performance of his obligation, discharges the surety. How-

ever, such an agreement must be supported by consideration in order that the surety shall be discharged. A simple agreement to extend the time upon a note already due would not discharge the surety since there would be no consideration, even though part payment were made at the time. A part payment made by the principal *before* the debt was due, for which the creditor agreed to extend the time for the payment of the remainder, would be binding because part payment before a debt is due constitutes good consideration; consequently the surety would be discharged. Similarly, the surety of a building contractor would be discharged by any material change consented to by the owner and the contractor. If an employee is bonded in the performance of certain duties that result from his position as a bookkeeper, the bond cannot be enforced against the surety if the employee is advanced to another and different position.

Surety's Obligation under New Contract—It frequently happens that the principal's contract is not completed on time and that a renewal is necessary. The question then arises as to whether the surety's obligation is continued under the new contract as under the old. The rule which the courts apply is that if the renewal amounts to an entirely new contract, then there is such a variation of the surety's original obligation that the surety is discharged. If the renewal is simply a part of the original contract and does not call for a new contract, the surety's obligation continues under the renewal.

Surrender of Securities by Creditor—It is often true that the creditor is given certain securities for the performance of the principal's obligation at the time when the original contract of suretyship is entered into. If the creditor surrenders them or a portion of them to the principal before the principal has performed, there is a variation in the surety's risk. Under such circumstances, some states hold that the surety is completely discharged, while others hold that he is simply discharged by the extent to which the surrender of the securities has injured him.

Conduct of the Creditor—The creditor cannot induce the surety to assume a particular risk by fraudulent representations as to the character of the risk, and he must disclose to the surety any facts which would materially increase the risk. If the creditor knows that a certain principal has been guilty of fraudulent or criminal misconduct, and he does not disclose this information to the surety who has bonded himself for the faithful performance of the principal's duties, the creditor cannot hold the surety. If an employee is retained after he has been guilty of dishonesty, and the employer has knowledge of his dishonesty, the surety must be informed of that fact and consent to the continuance of the employment; otherwise, he will be discharged from any liability for defalcations occurring subsequent to the discovery of the dishonesty.

Negligence of the Creditor—It is generally true that the creditor is under no obligation to be diligent

in the pursuit of his debtor. Consequently, mere delay, even though negligent, on the part of the creditor to collect a claim against his debtor, for which a surety is responsible, will not relieve the surety of his liability. In some states, however, statutes compel the creditor to sue the principal on demand by the surety and will discharge the surety if the creditor fails to comply with this demand. The suretyship contract may provide for certain steps to be taken by the creditor upon default by the principal and will discharge the surety if the creditor fails or neglects to take the steps that are thus provided.

The Surety's Right of Subrogation—It is a well established rule of law that where the surety is obliged to make good on his contract, he is entitled to relief against the person primarily responsible for the performance of the obligation which the surety was compelled to perform. This right is known as subrogation; that is, by paying the claim, the surety is subrogated to or acquires the same right which the creditor had against the principal debtor. If S pays C, S becomes entitled to whatever claim C had against P, and he can enforce it in the same manner that C could have done. To avail himself of this right, the payment by the surety must be one for which the surety was legally bound. If he pays the claim because it was a moral obligation, or for any other reason which the law would not recognize as legally binding, the surety will not possess the right to compel the principal to reimburse him for his outlay.

Right of Contribution—When one of two or more sureties for the same obligation has paid more than his share of the debt, he is entitled to be reimbursed for the excess by his co-sureties. This right is known as the right of contribution. The existence of this right does not depend upon a contract between the sureties, but it arises from their relationship toward each other. Since the one surety has by his payment relieved the others of a common burden, they ought to reimburse him for their proportionate part of the loss. In order to possess this right of contribution, the surety who pays must have been legally bound to do so. Thus, if one surety pays a debt that has been barred by the Statute of Limitations, he will not be entitled to contribution from his co-sureties since there was no legal obligation attached to the payment.

BANKRUPTCY AND INSOLVENCY

Insolvent Debtors—When a debtor is insolvent, he may do one of several things. In the first place, he may do nothing. This course naturally requires his creditors to get their money from him if they can. Formerly, when there was no bankruptcy law prevailing, either state or federal, a debtor could proceed in this way for a long time, and his creditors had to operate under what might be termed "grab law." This was the situation in many states before the passage of the National Bankruptcy Act. Before that time some states had their own bankruptcy laws, but these state laws have now been superseded by the national law, so

that, as far as bankruptcy proceedings are concerned, the law is uniform throughout the United States.

Composition with Creditors—The second thing that the debtor may conceivably do is to endeavor to make a composition with his creditors. A composition means that each creditor agrees to take a certain pro rata share of his claim in full discharge. Although it is the law that receiving a smaller sum will not discharge a liquidated debt for a larger amount, an exception to this rule prevails in the case of a composition where a number of creditors agree that each of them will take a smaller sum for his claim. In a composition, the debtor must deal equally with all his creditors, paying each the same percentage of his debt. He cannot pay one of them in full without the knowledge of the other creditors, for this gives the other creditors the right to set aside the composition agreement that has been made.

General Assignments—A third thing which a debtor may do is to make a general assignment of all his property to trustees for the purpose of paying his creditors. Though such an assignment is not valid in Massachusetts, it is recognized as valid in most states if free from fraud. In Massachusetts such an assignment, to be valid, must be made with the assent of the creditors; otherwise the creditors, or any one of them, may treat the assignment as invalid and attach the debtor's property just as if it had not been assigned. In other states, the assent of the creditors to the gen-

eral assignment is presumed if the assignment is not fraudulent.

Fraudulent Incidents of General Assignment—The effect of fraud accompanying a general assignment is to make the assignment void as against the creditors and to permit them to treat the property as if the debtor had not conveyed it away. What are the circumstances under which a general assignment will be regarded as fraudulent? In the first place, if the debtor is solvent when the general assignment is made, the transaction is fraudulent. If he had sufficient assets to pay all his debts, the only object he would have in making a general assignment would be to prevent his debts from being paid at once, since the creditors would have to wait until the assignees could realize upon the property to better advantage than would be had if it were disposed of at a forced sale.

In the second place, if the assignees are given an unlimited power to continue business, the assignment is fraudulent. In such a case, the business is in reality carried at the risk of the creditors. If the business proves unprofitable, the debtor loses nothing since he is already insolvent, while if the business proves profitable, the debtor receives whatever surplus remains after the payment of the debts. A provision authorizing the continuance of the business so far as is necessary to dispose of property on hand, or to work up raw material on hand, is generally upheld.

In the third place, a provision authorizing the trustees to make sales on credit is often but not uni-

formly regarded as being fraudulent since it permits the assignees to defer settlement of the estate. Under the bankruptcy act, a general assignment may be set aside within four months by bankruptcy proceedings, but any creditor who has once assented to a general assignment cannot thereafter join in a bankruptcy petition against the debtor.

Preferences Accompanying General Assignments—Prior to the enactment of bankruptcy statutes, it was not unlawful for a debtor who was unable to pay all his creditors in full to pay some of them in full, even though it meant that others would get less than their full claims or nothing. The debtor thus possessed the power to pick and choose the creditors whom he would pay in full. If he accomplished the same result through a general assignment, this action would not ordinarily invalidate the assignment. Thus, a general assignment of a debtor's property on a trust, under which the assignees were to pay certain named creditors in full and to pay the remaining creditors ratably out of the residue, was upheld at common law. Statutes in some states have made such assignments invalid.

A kind of preference held to be invalid, if it accompanied a general assignment, was one which was made conditional upon the creditors' giving the debtor a discharge. Since a general assignment, unlike a discharge in bankruptcy or a composition, did not relieve the debtor of that part of his debt as remained unpaid, debtors would seek to avoid this result by making a general assignment of their property in trust for ratable

distribution among such creditors as would give the debtor a discharge of all their claims. The effect of such a provision was to impose as a condition of a creditor's sharing in the benefit of the general assignment his consent to take his share in full satisfaction of his claim; hence the addition of this provision to a general assignment was held to make the general assignment fraudulent.

Bankruptcy—The fourth and most important method of settling the estates of insolvent persons is bankruptcy. Bankruptcy is the creation of statute law. The federal law, which supersedes all state laws upon the subject, was passed in 1898. Under its provisions two kinds of bankruptcy are possible: (1) voluntary bankruptcy, that is, by the voluntary petition of the bankrupt; and (2) involuntary bankruptcy, by means of which creditors petition a debtor into bankruptcy if he commits what is called an "act of bankruptcy." Its provisions are not applicable to all individuals or to all commercial corporations. When certain corporations become insolvent, such as railroads, insurance companies, and banking institutions, their affairs are settled by the method of receivership rather than by bankruptcy. Wage earners and farmers are also specially privileged. If they choose, they may become voluntary bankrupts, but they are not liable to be thrown into bankruptcy by involuntary proceedings. Jurisdiction over bankruptcy proceedings is vested exclusively in the United States district courts; the state courts possess no power to adjudicate one a bankrupt.

Petitions in Bankruptcy—If a debtor voluntarily wishes to become bankrupt, he files a petition in the United States district court setting forth the facts of his insolvency, the amount of his assets, and the debts that he owes. In the case of involuntary bankruptcy proceedings, it is necessary for three creditors, having claims in the aggregate that amount to not less than $500, to join in the petition for bankruptcy unless the whole number of creditors is less than twelve, in which event one creditor alone may petition for bankruptcy proceedings. The petition in bankruptcy must state (1) the creditors' claims, (2) the commission of an act of bankruptcy by the debtor, and (3) the fact that the debtor owes debts aggregating $1,000 or more. If a man is insolvent, he may become a voluntary bankrupt however slight his indebtedness, but he must owe at least $1,000 to be subjected to involuntary bankruptcy proceedings.

Fraudulent Conveyances—The commission of an act of bankruptcy is essential for the initiation of involuntary proceedings. What are acts of bankruptcy? In the first place, a fraudulent conveyance is an act of bankruptcy. There are many kinds of fraudulent conveyances. General assignments may be fraudulent. More common, however, is the fraudulent conveyance independent of any general assignment. If an insolvent debtor gives away a portion of his property, or if he is so near insolvency that the effect of such a gift will be to make him insolvent, this is a fraudulent conveyance, irrespective of the debtor's good intentions, because the

necessary effect of the gift is to hinder and delay his creditors. It is a fraudulent conveyance for a debtor to seek to conceal his property from his creditors by putting it in the hands of some friend to hold for him until his creditors shall cease to be troublesome. He might convey the property outright to this friend for a purely fictitious consideration, upon the agreement on the part of the friend to reconvey it to the debtor at a later time. This is one of the most common kinds of fraudulent conveyances. A sale of property by the debtor is not of itself a fraudulent conveyance, for presumably he receives equivalent value for the property he conveys away. But where the equivalent is very small, this is strong evidence that the sale is only a pretended one and that it is a fraudulent conveyance.

Preferences—A second act of bankruptcy is a preference. A preference is not a fraudulent conveyance since a creditor is entitled at law to payment in full; but bankruptcy proceeds on the theory that the creditors are to be treated equally and regards a preference as an act of bankruptcy. If a debtor himself gives a preference or allows a creditor to get a preference by legal proceedings, he is committing an act of bankruptcy. Any transfer of property made by an insolvent debtor to a creditor to pay or to secure a previously existing debt is a preference.

General Assignments—A general assignment, whether fraudulent or not, is an act of bankruptcy. Creditors who have assented to it cannot treat it as

such, but other creditors may have it set aside and may initiate bankruptcy proceedings. However, if these other creditors prefer, they may permit the assignment to stand and the estate to be settled under it.

Receiverships—The appointment of a receiver on account of insolvency is an act of bankruptcy. If they choose, creditors may let the receivership stand, that is, permit the receiver to distribute the assets, or they may begin bankruptcy proceedings instead.

Admission of Insolvency—An admission by a debtor of his inability to pay his debts and of his willingness to be adjudicated a bankrupt is also an act of bankruptcy.

Commission of Acts of Bankruptcy—In order for an act of bankruptcy to form the basis of a petition in bankruptcy, it must have been committed within four months of the time when the petition is filed. An insolvent debtor cannot very well avoid the commission of an act of bankruptcy. He can avoid making a fraudulent conveyance, but it is difficult for him to avoid making a preference. He need not, it is true, pay any of his debts, and it is not a preference to pay out money or to give property for present consideration, such as making a mortgage for a new loan. However, it is difficult for the debtor to prevent his creditors from getting a preference by legal proceedings; if the debtor fails to pay his debts, some creditor will sue him, get an execution, and attempt to levy on the debtor's property.

Procedure in Bankruptcy—When a petition has been filed and the court has found that it is true, the debtor is adjudicated a bankrupt. Then a referee in bankruptcy, who is a subordinate official of the court, requires the bankrupt to submit schedules of his assets and debts. The debtor must make these schedules as complete as possible. If the debtor intentionally omits any of his assets from the schedules, he is guilty of a crime and is liable to a jail sentence. If the schedules of his debts are incomplete, any creditor who is left out, or whose address is so incorrectly given that he does not receive notice of the proceedings in time to prove his claim, is not affected by the discharge. Since what the debtor wants is a discharge from as many debts as possible, there is a strong inducement for him to make the schedules of his creditors complete. Creditors are informed of the bankruptcy proceedings by notices sent out by the referee. The creditors then meet and choose a trustee. The function of the trustee is to collect the assets of the estate and, under the direction of the court, to pay dividends from these assets to the creditors.

The Trustee—The trustee acquires title to all the tangible property to which the debtor could transfer title at the time of his bankruptcy. He acquires all intangible property belonging to the debtor, such as patents, trademarks, and copyrights, except the right of the debtor to carry on his old business for the future in his own name. The trustee acquires all rights of action belonging to the bankrupt except those that are known as personal rights of action, which consist of

rights of action for personal injuries, as for assault, for negligence, or for breach of promise to marry. The trustee acquires the right to recover any property fraudulently conveyed by the bankrupt, except that which is in the hands of a bona fide purchaser, even though the fraudulent conveyance was made years before. The trustee also acquires the right to recover from the preferred creditor any preference made within four months immediately preceding the filing of the petition, provided the creditor had reasonable cause at the time he received the payment to believe that it was a preference. Such exemptions as the state law may give an insolvent debtor are recognized by the federal law, and the trustee acquires no right to property so exempt.

Except in so far as they are made exempt by statute, life insurance policies of the bankrupt also belong to the trustee where the bankrupt himself was the beneficiary, or where he reserved a right to change the beneficiary. Life insurance policies in favor of a beneficiary other than the bankrupt are exempt, but if the premiums were paid by the bankrupt when he was insolvent, all such premiums would be considered fraudulent conveyances which the trustee might recover. Therefore, the beneficiary would have to pay back these premiums in order to hold the policy.

Property passing to the trustee passes free of attachment or judgment liens secured by the creditors during the four months immediately preceding the petition. Any attachment or lien more than four months old is effective; hence the creditor can collect his claim out

of the property even though the bankruptcy proceedings intervene before the creditor secures final judgment. Property acquired by the bankrupt after the beginning of the bankruptcy proceedings does not pass to the trustee.

Proof of Claims—The creditors must prove their claims while the trustee is engaged in the process of reducing the estate to cash. Only claims that exist at the time of filing the petition are provable, but the debts need not be due at the time of the bankruptcy. Interest is added or rebated, as the case may be, effective as of the date of filing the petition. If there is an interest-bearing note payable on July 1 and the debtor becomes bankrupt on May 1, interest will be provable only up to May 1. If there is a non-interest-bearing note payable on July 1, the face of the note will be provable less a rebate of two months' interest to May 1, because the present value of the note on May 1 is what is provable. If the note had been due on April 1, interest would be added up to May 1.

Only contract claims are provable. While claims arising out of torts are not provable, a judgment for a tort obtained before the filing of the petition is provable. Contingent claims present a great deal of difficulty. These are claims which may or may not become due in the future, such as the liability of an indorser on an unmatured note. The maker may or may not pay the note, and the holder may or may not give the indorser notice of the default. Creditors who received preference cannot prove their claims unless they

surrendered, within four months prior to the bankruptcy, any preferences which they took, reasonably believing them to be such. A secured creditor can realize upon his security and then prove for the balance of the debt.

A few claims are entitled to priority and must be paid before any dividend is paid to the other creditors. The most important of these are taxes and the wages of workmen, clerks, or servants earned within three months of the bankruptcy, not exceeding the sum of $300 to each claimant. Claims arising subsequent to the date of filing the petition are not provable but must be enforced against such assets of the bankrupt as he may acquire after bankruptcy.

Set-off—A set-off may be made by a debtor to the bankrupt provided he has a claim against the bankrupt. Thus, one who owes the bankrupt money and who is in turn owed by the bankrupt need not pay his debt in full and then take a dividend on his claim against the bankrupt. He may set one claim off against the other. But a debtor to the bankrupt may not acquire claims against the bankrupt for the purpose of set-off within four months of the bankruptcy. Otherwise, a person who owed money to an insolvent debtor could buy up at a discount claims against that debtor which would equal his own indebtedness to that debtor.

Examination and Discharge of Bankrupt—The bankrupt may be examined by any creditor with a view to making a disclosure of his assets. This is an impor-

tant right for creditors to possess because of the many frauds that are and may be committed by bankrupts. If the bankrupt has obeyed the bankruptcy law in all respects, he is entitled to a discharge, which will operate to discharge him of all provable claims existing at the date of his bankruptcy. However, certain liabilities of the bankrupt are not affected by the discharge, such as claims for obtaining property by false pretences, claims for defalcation or embezzlement, claims for wilful and malicious injury to property, claims for alimony or for the support of his wife or dependent children, and taxes.

The bankrupt may be refused his discharge for several reasons, such as making a fraudulent conveyance, obtaining credit by false pretences, having failed to keep books of account for the purpose of concealing his financial condition, having committed an offense punishable by the bankruptcy laws, that is, making a false oath or refusing to disclose his property or refusing to submit to an examination. Moreover, a debtor who has been discharged in bankruptcy within the previous six years cannot, as a voluntary bankrupt, obtain a discharge.

Composition in Bankruptcy—Aside from any bankruptcy statute, it was necessary under the old law for a debtor to secure the assent of all his creditors in order to make a composition effective against all of them. The bankruptcy act provides a new method whereby, with the approval of the court, a composition may be effected which will bind all the creditors, even though they have not all assented to it. Such a compo-

sition may be effected if a majority of the creditors, both in number and amount of claims, wish to assent to the composition. The debtor will be discharged in the same manner in which he would be discharged in bankruptcy. The reason for effecting a composition instead of resorting to a discharge in bankruptcy is that under certain circumstances the creditors believe that they will be benefited in the end by saving the costs incurred by bankruptcy proceedings. The approval of the court to such an agreement is required in order that a majority of the creditors shall not be able to take undue advantage of a minority.

CONFLICT OF LAWS

Nature of Problems—Legal transactions commonly take place in more than one jurisdiction. If all the jurisdictions had the same laws, there would be no such thing as a conflict of laws, but the laws of this country and those of other countries differ in varying degrees, as do the laws of the various states within this country. The question continually arises as to what law governs a particular transaction or a portion of that transaction. Suppose A in New York makes an offer to B in Boston which B accepts by mail in Boston. Suppose that B is twenty years old. The law of New York provides that an infant shall reach his majority at twenty-one, while the law of Massachusetts provides that an infant shall reach his majority at twenty. Can B, if he chooses, elect to rescind this contract? or is he irrevocably bound? Suppose that the contract calls for

the sale of certain securities which fall within the prohibition of the Massachusetts blue sky law, but that New York has no such law. Is the contract valid or unenforceable? In both of these cases the answer depends upon whether the law of New York or that of Massachusetts governs the transaction.

Suppose that B commits a breach of the contract and that five years elapse after the breach. The New York Statute of Limitations, let us assume, is five years, that of Massachusetts six years. Is B liable to A or not? Would it make any difference if B were sued in a New York court rather than in a Massachusetts court? If B lived in Hartford, would suit in a Connecticut court make any difference?

Conflict of Laws—The answers to these questions depend upon the problem of what law will be deemed to govern the particular transaction or its incidents. That problem is not a haphazard one. We would expect essentially the same results to be reached in these cases by a New York court as by a Massachusetts court or by a Connecticut court, the liability of B not depending upon the accident of where he might be sued. This is true in the main. The principles as to what law governs a particular transaction have been developed by the various courts, and this body of principles goes under the name of conflict of laws. There are differences of opinion on the part of the various courts as to what are the controlling principles in the field of conflict of laws. Different principles have grown up in the different states; hence, any statement that a certain

rule is a principle in the field of conflict of laws must be guardedly made, for it may very well be the prevailing rule in one state but not in another.

Conflict of Laws Relating to the Distribution of Property—In the distribution of an estate of any magnitude, it will generally be found that the assets of the estate are scattered through several different states. These assets consist of real and personal property. The transfer of title to this property is always under the control of the state in which the property is situated. But what law will that state apply in determining who is entitled to the property? Will it apply its own law or the law of the state in which the deceased was domiciled? Here the courts make a distinction between real and personal property, holding to the rule that the transfer of real property is governed by the law of the state in which the property is situated, and that the transfer of personal property is governed by the law of the domicile of the deceased.

Suppose that a person domiciled in Texas died leaving real property in Illinois, that he left no will, and that the statutes of distribution in Texas and Illinois were different. The heir as determined by the Illinois law would be entitled to the property. If, on the other hand, the property in Illinois consisted of personal property, the next of kin as determined by the Texas law would acquire the property.

Suppose that a testator domiciled in New York made a will, with only two witnesses, bequeathing his personal and real property situated in Massachusetts

to X. Massachusetts requires three witnesses to a will; consequently, the will would not be effective to pass title to the real property situated in Massachusetts. The real property would have to pass under the Massachusetts Statute of Distribution, although the will would be perfectly effective to transfer the personal property in Massachusetts.

Conflict of Laws Relating to Contracts—The problems that arise with reference to the application of the rules of conflict of laws to contracts concern primarily questions of form, questions as to the nature and validity of the obligation created, questions of interpretation, of rights centering about performance, and of discharge. Two places are also concerned, namely, the place where the contract is to be performed and the place where the contract is made. The former is not difficult to determine. But where is the place that a contract is made? It is the place where the last act necessary to create the obligation is performed. If delivery is necessary, as in the case of a sealed instrument or of a promissory note, it will be the place where delivery is made. In the case of a simple contract, it will be the place where the acceptance becomes effective, which is ordinarily the place of mailing the acceptance. Consequently, an offer from a New York merchant accepted by mailing in Boston will make a contract in Boston.

Form—All questions of form are governed by the law of the place where the contract is made. Thus, the provisions of the Statute of Frauds of the state in which

the contract is made will govern the contract. The same rule applies to other statutes requiring contracts to be in writing.

Obligation Created—The most general rule followed in the United States is the rule that the law of the place of making the contract will govern the question of what obligations are created under the contract. The capacity of the parties to contract is determined by the place where the contract is made. The question of the extent of the obligation assumed by the parties and questions as to the legality and enforceability of the contract are similarly governed.

Suppose A buys of the B steamship company in Liverpool a ticket which contains a clause exempting the company from any liability for loss of the passenger's baggage, even though such loss be caused by the company's own negligence. En route to Boston the baggage is destroyed through the company's negligence. A sues in Massachusetts for the loss of the baggage, and the company defends under the clause exempting it from liability. Under the Massachusetts law, such a contract by a carrier is against public policy and unenforceable, but it is perfectly valid under the English law. The Massachusetts court in such a case (Fonesca v. Cunard S. S. Co., 153 Mass. 553) rightly held that the company was not liable inasmuch as the contract was perfectly valid under English law and that it was the law of the place where the contract was made that controlled.

To this principle there is a well recognized excep-

tion, namely, that even though the contract is valid by the law of the place where it was made, the court in which it is sought to be enforced will not enforce it if it is against the public policy of that state. Thus, even though a Turk can make a valid contract in Turkey to marry a woman when he already has one wife, no American court will enforce such a contract since it is against the general policy of the country.

Exceptions—This general rule is subject to many exceptions in the various states. Some states adopt a different rule, namely, that where the contract is to be performed in a state other than the one in which it is made, the law of the place of performance will govern the validity of the contract. A few states lay down the rule that the law which the parties *intended* to govern the contract shall determine its validity; that law may be the law of the place of making, the law of the place of performance, or the law of the obligor's domicile.

Conflict of Laws as Relating to Negotiable Paper—There is not so large a field for questions of conflict of laws to come up in negotiable paper as in some of the other subjects we have been considering. All the states have passed the Uniform Negotiable Instruments Law, but the interpretation of this law in the various states is not invariably uniform. Suppose a promissory note has six indorsers. Every indorsement is governed by the law of the state where it was made, and should there be differences in interpretation, we would at once have a question in conflict of laws. Again,

in determining the negotiability of a document made in one place and payable in another, we have a further question in conflict of laws. The authorities do not agree here although perhaps we may say the majority hold that the law of place of payment controls. These problems will be considered in the textbook on Negotiable Instruments.

Usury Contracts—In cases where the validity of the contract is threatened by the usury statutes, the courts are more at variance than in any other cases. The tendency is to uphold the validity of the contract if possible. Many states lay down the principle that if the contract is valid either by the law of the place of making or by the law of the place of performance, the contract will be upheld. The rule here should be, as elsewhere, that the validity of the contract should be governed by the law of the place where it is made, for the evil of usury consists in the hardship of the bargain, and that is the concern of the state where the bargain is made.

Interpretation—Parties commonly use words in a sense with which they are familiar. Their language is generally that of their domicile. For this reason the law of the domicile of the user should govern the interpretation of the words that he used. It is very often difficult to determine which party was the user of any particular words in a contract. In an insurance contract, the printed words would be those of the insurer, while the written words would be those of the insured.

In other cases, a party who contends that a particular law should govern the interpretation of certain words must show their usage by a person domiciled within a state governed by that law.

Performance — The question often arises as to whether the doing of a certain act constitutes a performance of an obligation that has been assumed, or whether it is a breach for which a cause of action lies. This question of law is determined by the law of the place where performance is due. The question of whether the obligor will be legally excused by the happening of certain acts which make the performance of a contract impossible is determined by the law of the place of performance. Similarly, the measure of damages consequent upon a breach is determined by the law of the place of performance, for it is that law which gives a right to damages consequent upon the breach of a contract.

Statute of Limitations—The question of whether the Statute of Limitations has run against a particular plaintiff's claim, or whether that claim lies in contract or in tort, is generally determined by the law of the place where the suit is brought. The reasons for this rule seem questionable, but its origin is traceable to the historic attitude of the courts toward statutes of limitations.

Procedure—Many matters in the enforcement of rights relate to procedure, such as whether a wife is

qualified to testify for or against her husband, whether a particular claim is allowable as a set-off, who has the burden of proving certain facts, and the application of the rules of evidence. Matters of procedure are always governed by the law of the place where the suit is brought. There is no great hardship in the application of such principles because the courts of the state where the contract was made are open to the parties, and if they wish to avail themselves of the services of a court in a different jurisdiction, they must be willing to accept its rules of procedure.

CHAPTER XIX

Negotiable Instruments

THE term negotiable paper ordinarily includes merely promissory notes, bills of exchange, and checks. The law governing negotiable paper originated many centuries ago from the custom of merchants on the continent of Europe. It was gradually introduced into England, and its principles became incorporated into the common law. The necessity for having uniformity in the legal rules governing negotiable paper becomes apparent when one remembers that these instruments pass from hand to hand like money and travel from state to state. It was because of the desirability of having such uniformity and also because of the lack of uniformity in the decisions of different state courts dealing with negotiable instruments that in 1896 the Commissioners on Uniform State Laws prepared and recommended for passage the Uniform Negotiable Instruments Law. This law has since been adopted by every state in the Union and by the District of Columbia, Hawaii, Alaska, Porto Rico, and the Philippines. The Negotiable Instruments Law, or N. I. L. as it is conveniently called, covers with minute detail the various rules of law that govern negotiable instruments and should be referred to on any problem that may arise concerning them.

Nature of Negotiability—Negotiability has been defined as that quality whereby a bill, note, or check

passes freely from hand to hand like currency. These instruments are really substitutes for currency because they possess this quality of negotiability. The characteristics of negotiability have been referred to in our discussion of bills of lading and warehouse receipts. The distinction between negotiability and mere assignability should be kept in mind. The purchaser for value and in good faith of a negotiable instrument acquires title to the instrument although the person from whom he purchases may not have title to it. He acquires it free from defenses which may have been available as against the seller of the instrument. The assignee, on the other hand, is subjected to such defenses and takes only the title that his assignor had. The full meaning of negotiability as it concerns negotiable instruments becomes apparent only after one has acquired a knowledge of the law governing negotiable instruments.

Types of Negotiable Instruments—The three chief types of negotiable instruments are the promissory note, the bill of exchange, and the check. A note is an instrument that contains a promise by a person, called its maker, to pay a sum of money on demand or at some fixed or determinable future time to order or to bearer. The person to whom the note is made payable is known as the payee. A bill of exchange is an order in writing by a person, known as the drawer, to another person, known as the drawee, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum of money to order or to bearer. A check is a variation of a bill of exchange; it

is a bill of exchange drawn on a bank and payable on demand. Other types of negotiable instruments less frequently used are certificates of deposit, bank notes, corporate bonds which are in essence variations of promissory notes, and trade acceptances which are variations of a bill of exchange. To be deemed negotiable, instruments, including those just mentioned, must as a matter of law live up to the requirements of negotiability as set forth in the Negotiable Instruments Law. The question of whether any instrument is negotiable is not a matter of commercial practice but one of law dependent upon whether the instrument conforms with the requirements as set forth in the N. I. L. Bills of lading and warehouse receipts are governed by the uniform statutes concerning them and thus do not depend for their negotiability upon the N. I. L. What requirements are necessary to make a negotiable instrument?

Writing and Signature—Every negotiable instrument must be in writing and signed by the proper person or by his duly authorized agent. The writing ordinarily is in ink, or in a combination of ink and printing, but it need not be so. It may be in pencil, or the signature of the drawer or maker may be printed or stamped on the paper.

The Necessity for a Promise or Order—A second requirement for negotiability is the requirement that the instrument must contain a promise or an order. If it is a promissory note, it must contain a promise; if it is a bill of exchange, it must contain an order.

A mere statement of indebtedness is insufficient. Thus a writing that reads, "I.O.U. $100, John Jones," is not a promissory note.

The Promise Must Be Unconditional—The promise or order that the instrument contains must be unconditional. Thus an instrument that reads, "I promise to pay to B or order $100 when I attain my twenty-fifth birthday," is not a negotiable promissory note, since payment is subject to the contingency that the maker reach the age of twenty-five, a contingency which may never happen. On the other hand a note which reads, "I promise to pay to B or order $100 six months after my death," is negotiable, for the promise is unconditional within the meaning of that term as applied to negotiable instruments. The maker is certain to die, so the payment is certain to become due at some future time.

One of the most common types of conditional promises is the promise to pay out of a particular fund. Thus a note which reads, "I promise to pay $100 out of the proceeds of the sale of this year's harvest," is not negotiable since it contains a conditional promise. However, a mere reference to a fund which is to be debited with the payment of the instrument does not make a promise conditional. Thus a draft which reads, "Pay to the order of B $100, to be charged to the account of 50 bbls. of sugar," is unconditional and therefore is negotiable. Here the fund is referred to merely as the source from which the drawee is to reimburse himself.

Another case of a conditional promise is where the

terms refer to another document. Thus a note which reads, "I promise to pay $100 on July 1, 1930, in accordance with and subject to the terms of a deed of trust filed and deposited with the X bank," is non-negotiable. The terms of the document to which reference is made have no bearing on the case. The mere reference to such a document and the fact that the promise is made subject to its terms render the original promise conditional.

Words of Negotiability—Every negotiable instrument must also contain words of negotiability. These words are "to order," "to bearer," "to holder," or their equivalent. A note which reads, "I promise to pay John Jones $100," is not a negotiable promissory note for it lacks the words "or order" or "or bearer." In taking negotiable paper, therefore, it is always important to notice whether either one of these phrases is present. If it is not, the holder will lose the peculiar advantages and rights which he might otherwise acquire by the operation of the law of negotiability.

Payment in Money—Negotiable instruments must also be payable in money. An instrument which contains a promise to pay 100 bushels of wheat or 500 pounds of tobacco is non-negotiable. The instrument also must not contain a promise to do anything other than to pay a sum of money. A promissory note which includes a promise to give a horse in addition to paying a certain sum of money is non-negotiable. The reason for this rule is that one must be able to evaluate the

worth of any negotiable instrument easily and without going outside its four corners. It would be impossible to do so if the holder were entitled to get things other than money in payment of the note.

Bearer Paper—Order paper is easily defined. It is paper payable to a named person or to his order. The ordinary type of bearer paper is paper made payable to a named person or to bearer, or simply made payable to bearer. But paper which is made payable in such a way that the name of the payee does not purport to be the name of any person is also payable to bearer. Thus a note payable to "cash" or "account rendered" or "cash account" is payable to bearer. Another type of bearer paper is paper in which the named payee is a fictitious person. If A makes a note payable to "John Jones," intending John Jones to represent a purely fictitious person, the instrument is payable to bearer. It makes no difference that there is a John Jones in existence, for the intention of the maker or drawer that the name John Jones shall represent a fictitious person controls. He intends the payee to be a fictitious person and because of this intention the instrument becomes a bearer instrument. Another type of bearer instrument is one where the last indorsement is in blank. Thus an instrument may start out as an order instrument but by indorsement become a bearer instrument.

CONSIDERATION AND NEGOTIATION

Necessity for Consideration—The contracts of

the parties to a negotiable instrument, like any contract, must be supported by consideration to be enforceable. Two differences between the enforcement of the obligations of parties to a negotiable instrument and the enforcement of ordinary contractual obligations must be noted. The first is that every negotiable instrument is deemed to have been issued for a valuable consideration. This is a rule of evidence that allows a party to sue without alleging or proving consideration. The absence of consideration thus becomes a matter of defense and must be proved by the party who insists upon its absence as a defense to his liability. The second difference is the important one that absence of consideration is only a defense against persons who are not holders of the instrument in due course. Any one who purchases a negotiable instrument without knowledge that it had no consideration back of it when it was issued can hold the parties to the instrument. If A gives B a note purely as a gift, B cannot recover from A on the note since A can prove the absence of any consideration supporting his promise. However, if B sells this note to C who has no knowledge of the fact that A received no consideration for it, C can recover from A on the note since absence of consideration is no defense against him. If C transfers the note to D as a gift, D cannot assert that he is a holder of the instrument in due course, but he nevertheless can claim all the rights of C on the instrument. Therefore he can recover from A on the note.

Intention to Make an Instrument—In order for

a valid negotiable instrument to exist, its maker must have intended to make an instrument. Suppose, for example, a German who is unable to read and write English is induced by a payee to sign an instrument in the form of a promissory note, relying upon the false statement made by the payee that the paper is a contract appointing the German an agent to sell a patent right. The payee then sells the instrument to C who has no knowledge of the fraud that has been practised upon its maker. The instrument, though complete in form, is not the maker's instrument since he had no intention of making such an instrument, and C has acquired nothing by his purchase.

Contrast this case with the following one. Suppose B hands A a paper with a promissory note printed on it, complete in every detail except for A's signature. B asks A to sign the paper. A does so without reading it over or asking what it is and gives it back to B who then negotiates it to C, a purchaser in good faith and for value. Is A liable on this note? It is true that A did not intend to sign a promissory note, but he was careless in signing something which he did not read over. Consequently he will be fixed with liability because it was through his own carelessness that he issued a promissory note. The German was in a different situation. He was not careless. He could not read English and was obliged to rely upon some one to tell him what the document was. If he used due care in selecting a responsible person to explain to him the nature of the document, he did all that the law required. However, if he had been imposed upon on several pre-

vious occasions by the same person, but in spite of it relied upon this person to explain to him the nature of the document, any court would regard this as negligence and would find the German liable to C.

Delivery—In addition to the intentional signing of the instrument, there must also be a delivery in order to complete its validity. By delivery is meant an intentional transfer of possession from one party to another. Thus if A makes a note payable to X for $100 but fails to deliver it to him, and the note is found among A's papers after his death, no obligation will be imposed either upon A or upon his estate. This rule that requires delivery is accompanied by another rule that the fact of delivery will always be presumed where the instrument has come into the hands of a holder in due course. Suppose A writes out several promissory notes or checks payable to bearer and locks them in his safe or leaves them on his desk. The checks are stolen from him by X. X then sells them to C who knows nothing of the theft. There has been no delivery of the instruments, but since C is a holder in due course the fact of delivery is presumed and C can recover against A on the instruments. Suppose A indorses a check in blank and mails it to B. The letter is mistakenly delivered to X who opens it, finds the check, and gives it to C in payment of his grocery bill. C takes it in good faith. Again there has been no delivery of the check to X, but since C is a holder in due course, the want of delivery becomes immaterial, and A will be liable to C on his indorsement.

Delivery of Incomplete Instrument—Where the instrument is incomplete at the time it leaves the issuer's hands, want of delivery is a defense against any subsequent holder of the instrument and it makes no difference that this holder is a holder in due course. Suppose A signs several bearer checks, leaving in blank the amount for which they are payable and locks them in his safe. X steals one from the safe, fills it out for $1,000, and sells it to C who takes it without knowledge of the fraud. C cannot recover from A, inasmuch as the instrument was incomplete at the time it got out of A's possession. A can set up the lack of delivery as a defense to his liability on the instrument. If A had been extremely careless, however, it seems that the rule would be otherwise. Thus if A signs a promissory note with the amount left blank and puts it in his desk, and X takes the note, fills it out for $1,000, and sells it to C who has no notice of the fraud, it seems that C will be able to recover on this note. X will probably have fled or be financially irresponsible, and as between the two innocent parties, A and C, the loss should fall on A whose carelessness brought it about.

Blanks—Suppose A makes out a promissory note payable to B leaving the amount in blank, and gives B authority to fill it out for $100. B fills it out for $1,000 instead of $100 and sells it to C. Can C recover on the note if he knew nothing of B's fraud? This depends upon whether C knew that the instrument was incomplete when it was delivered to B. If C knew this fact and knew that B had authority to fill it out, he will not

be able to recover more than $100 on the note, although he honestly believed that the authority extended to filling it out for $1,000. The existence of blanks on an instrument is notice to any purchaser of that instrument. He must be sure that the person who offers it to him has the authority to fill it out for the amount specified. If, however, C did not know that the instrument was incomplete when it was signed by A and took it in good faith and for value, he will be allowed to recover the full amount of the instrument. It makes no difference that false representations were made to C by B, provided C had no knowledge that the instrument was incomplete when it was delivered.

Negotiation—The transfer or negotiation of a negotiable instrument from one party to another may be effected in two ways. If the instrument is payable to bearer, a complete negotiation is effected by the simple transfer of possession. If the instrument is an order instrument, the transfer of possession must be accompanied by an indorsement of the paper. It frequently happens that an order instrument is inadvertently transferred from one party to another without an indorsement. In such a case the transferee acquires title to the paper and the right to get an indorsement from the prior holder, but for the purposes of determining whether the transferee is a holder in due course, the time of indorsement, not the time of the transfer, becomes important. Suppose that B by fraud induces A to make a promissory note payable to B's order for $100. He then transfers it without indorsement to C

who takes it in good faith and pays value for it. C then learns of the fraud that B practised on A and thereafter he gets B to indorse the note. If C had secured B's indorsement at the time the note was transferred to him, he could have recovered from A since he had purchased it in perfect good faith and had no knowledge of the fraud. But since he did have such knowledge at the time he acquired the indorsement he cannot claim that he acquired the indorsement without any knowledge of B's fraud. Consequently, he cannot claim to be a holder in due course and therefore cannot recover against A.

Holder in Due Course—We have used this term generally synonymously with purchaser in good faith and for value. It deserves a more exact definition since the position of a holder in due course is one that is so greatly favored by the law that it often becomes important to determine whether a particular party can claim to occupy that position. Four things are necessary in order to constitute a holder in due course.

1. The instrument must have been complete and regular on its face. If there were blanks on the instrument when it was offered to or acquired by the holder, he cannot claim to be a holder in due course.

2. The holder must have acquired the instrument before it was overdue and without knowledge that it had previously been dishonored. The date when an instrument is overdue is ordinarily the date when it is payable. If it is a demand instrument, it becomes overdue a reasonable time after its issuance. After the ex-

piration of this time, known as the maturity of the instrument, there can be no holders in due course. This means, of course, that it is rarely wise to take matured paper or demand paper that has been outstanding for a long time, since a purchaser of such paper cannot claim to occupy the position of a holder in due course.

3. The holder must have taken the instrument in good faith and for value. It is not necessary that he shall have paid the full value of the instrument. Any value is sufficient provided that it has all been given before any notice of defects in the instrument is acquired. Suppose C buys a $200 note agreeing to pay $150 for it and pays down $100 promising to give $50 more. If at the time he gives the $50 he has notice of a defense of fraud on the part of the maker, he cannot claim to be a holder in due course, even though he was wholly ignorant of the fraud at the time he paid the $100 and agreed to pay the balance.

4. At the time he takes the instrument the holder must have no knowledge of any defect in the title of the person negotiating the instrument to him. If he knows that the seller acquired the note by fraud, he cannot claim to be a holder in due course. But he must actually have known such a fact. That as a reasonably prudent person he should have known the fact is insufficient, for the law permits honest though imprudent men to claim as holders in due course.

Real and Personal Defenses—A holder in due course takes free of all personal defenses but is still subject to what are known as real defenses. Furthermore,

any person claiming under a holder in due course can assert the same rights that the holder in due course could have asserted, for once the chain of title to a negotiable instrument discloses a holder in due course, personal defenses cease to be available against all subsequent parties to the instrument. Personal defenses include such defenses as failure of consideration, want of consideration, fraud, duress, and discharge. Illegality is sometimes a personal defense and sometimes a real defense. The nature of illegality as a defense varies in the different states and depends largely upon the quality of the illegality. A violation of the Sunday laws, for example, is usually only a personal defense unless the instrument itself shows clearly that it was issued on Sunday. Some states treat usury and gaming as personal defenses while others treat them as real defenses.

The chief real defenses are incapacity due to infancy or insanity, lack of title in order instruments, and forgery. Alteration is also a real defense, but the holder can recover on an altered instrument the amount for which it was originally payable. Thus, if B raises A's promissory note from $100 to $1,000 and sells it to C who takes it in good faith and without knowledge of the alteration, C can recover against A $100 but not $1,000. If the alteration had been facilitated by the careless method in which A had written the instrument, it is possible that the courts would follow the old common law rule which permitted the holder in such cases to recover from the maker the full amount of the raised instrument.

ACCEPTANCE AND INDORSEMENT

Acceptance—The holder of a bill of exchange payable otherwise than on demand will ordinarily take the instrument to the drawee and request an acceptance from him. In the majority of cases it is unnecessary for the holder to present the bill for acceptance; he may simply wait until maturity and present the bill to the drawee for payment. Refusal of the drawee to accept or pay, as the case may be, operates as a dishonor of the instrument, since the drawer promises that the bill will be both accepted and paid. The drawee accepts the bill by writing across the face of it "Accepted," signing his name, and perhaps adding the name of the bank at which the instrument is payable. Under the Negotiable Instruments Law, an acceptance must be in writing and must be signed by the drawee. However, the acceptance need not necessarily be on the bill. It may be written on a separate piece of paper, although the holder may demand that the acceptance be written on the instrument and may treat as a dishonor a refusal on the part of the drawee to give him this kind of an acceptance. If the acceptance is written upon some other instrument, it is only an acceptance so far as those who have taken the bill for value upon the strength of such a writing are concerned. Thus, the holder cannot treat as an acceptance one written upon a separate piece of paper after he has acquired the instrument.

Qualified Acceptances—A holder may always refuse to take a qualified or conditional acceptance, and

if the drawee will give him none other than a qualified acceptance, the holder may treat the bill as dishonored. However, the holder may, if he chooses, take a conditional acceptance. The effect of doing so is to discharge the drawer and indorsers unless they consent to such action. Consent by them will be deemed to have been given when, knowing of the fact, they remain silent. If they insist upon being discharged as a result of the holder's taking a qualified acceptance, they must expressly announce their dissent to the holder. Ordinarily an acceptance of the bill does not discharge the holder and indorsers, since they promise that the bill will be both accepted and paid.

Acceptance by Destruction — It is not always possible for the drawee to know whether he has sufficient funds to justify an acceptance, and so the Negotiable Instruments Law gives him twenty-four hours within which to make up his mind. During that time the holder is obliged to wait without taking any further action. If the drawee refuses to return the bill after the expiration of twenty-four hours or if he destroys the bill, he is treated as having accepted it. Then, upon the maturity of the instrument, the holder may demand payment from the drawee, and in case of refusal he may charge the drawer and indorsers.

Certification—Certification of a check by the bank on which it is drawn is equivalent to an acceptance. Upon certification, the bank assumes the same general liabilities that any acceptor of a bill of exchange as-

sumes by his acceptance. As to whether the drawer and indorsers are discharged, however, depends upon whether the check was certified at the request of the drawer or at the request of the holder of the check. When a check is certified by the bank for the drawer before he delivers it to the payee, the drawer is not discharged from liability to the holder in the event the certifying bank fails. In fact, the drawer may be sued on a check which he has had certified even if the certifying bank has not failed. However, when the holder of a check procures its certification, the drawer and all indorsers are discharged from liability on the check. In this case the holder of the check has rights only against the certifying bank, and if that bank refuses or is unable to pay, he cannot recover from the drawer and indorsers.

Types of Indorsements—Where a person simply writes his name on the back of the instrument in the same fashion in which the instrument is made payable to him, he has indorsed the instrument in blank. Such an instrument then becomes a bearer instrument and may be negotiated further simply by transfer. If the payee indorses an instrument in blank and the instrument is stolen from him and sold by the thief to a purchaser in good faith and for value, that purchaser then becomes a holder in due course and can recover against any party to the instrument.

The indorsement may be what is known as a special indorsement. The payee, C, may wish to transfer the note to D and so writes across the back, "Pay to the order of D." Signed "C." Such an indorsement prevents

any further negotiation of the instrument without the indorsement of the person to whom the instrument is so made payable. If the instrument is stolen from D and sold by the thief to a purchaser in good faith and for value, the purchaser cannot claim as a holder in due course, for the instrument either lacks the indorsement of D or has a forged indorsement of D on it. It is therefore advisable for one who wishes to send a check through the mail to indorse it specially so as to avoid the dangers arising from loss or theft of the instrument.

A third type of indorsement is the restrictive indorsement, which prevents further negotiation of the instrument. If a payee indorses the instrument, "Pay to D only," D cannot thereafter negotiate the instrument; he can simply present it for payment. Another form of the restrictive indorsement is commonly used in depositing checks and other instruments in the bank for one's account. The indorsement should read "for collection" or "for deposit" with the indorser's signature. This constitutes the bank the agent of the indorser for collection but not for any other purpose. It also authorizes the bank, in case payment is refused, to bring suit upon the instrument and collect its proceeds for the indorser.

A fourth type of indorsement is the qualified indorsement. This is frequently used where the indorser does not wish to assume liability for the payment of the instrument. He adds to his indorsement on the instrument the phrase "without recourse." Such an indorsement, as we shall see, does not relieve the indorser of all liability.

Accommodation Indorser—It is not unusual for one party to indorse an instrument for the accommodation of another. B may be unwilling to take A's note in payment of A's debt unless A will get another person also to assume responsibility for the payment of the note. A then gets X to indorse the instrument, makes it payable to B, and gives it to B in payment of the debt. In such a situation X is an indorser, not in the chain of title but an accommodation indorser who can be held for non-payment of the note by the maker. Accommodation indorsers can be held even though they have received no consideration for so accommodating a party provided that the person who took the note gave value for it. It is immaterial that the party who took the note had knowledge of the fact that the accommodation indorser received no consideration for his indorsement. Accommodation indorsers may indorse instruments for the accommodation of parties other than the maker or drawer of the instrument. For example, they may indorse for the accommodation of the payee. In such a case any person subsequent to the payee can hold the accommodation indorser upon his indorsement.

LIABILITIES OF PARTIES

The Maker—The maker of a promissory note promises that he will pay the instrument according to its tenor. No demand need be made upon the maker to hold him liable. He is a party primarily liable upon the instrument and can be sued without demanding payment in advance. The maker also admits the ex-

istence of the payee and his capacity to indorse the instrument, and such admission prevents the maker from asserting, when sued by the holder, that the payee had no capacity to indorse the instrument to him.

The Drawer—The drawer, like the maker, admits the existence of the payee and his capacity to indorse the instrument. He is not, however, a party primarily liable upon the instrument. He simply promises that the instrument will be accepted or paid, or both, as the case may be, and that if it is not paid or accepted and he is properly notified of this dishonor, he will pay the amount of the instrument to the holder or to any subsequent indorser compelled to pay it. The liability of the drawer is thus a secondary liability, being conditional upon dishonor of the instrument by the drawee and the taking of proper proceedings consequent upon such dishonor.

The Acceptor—The drawee of an instrument is not under any liability to the holder. He is not legally required either to accept or to pay the instrument, except in so far as he may have promised the drawer to take such an action. But no right upon refusal by the drawee to accept or to pay arises against him on the part of the holder of the instrument. Such rights as the holder possesses upon refusal to accept or to pay lie against the drawer and indorsers. When the drawee accepts the instrument, however, he then becomes liable to pay it, and as such he is a party primarily liable to pay the instrument.

The acceptor admits not only the existence of the payee and his capacity to indorse, but also the existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument. Suppose that B draws a bill of exchange payable to himself and forges A's name as drawer of the bill and that B then indorses the instrument to C who takes it in good faith and for value. C takes the instrument to the named drawee and the drawee, ignorant of the forgery, accepts the bill. The drawee, having admitted the existence of the drawer and the genuineness of his signature, must now pay the instrument. If the drawee had simply paid the instrument without accepting it, he could not recover the payment from a holder in due course, since by his payment he admitted the existence of the drawer and the genuineness of his signature.

Suppose, however, that a bill drawn by A is made payable to B. It is stolen from B by X, who forges B's indorsement and negotiates it to C, who takes it in good faith and for value. C then gets it accepted by the named drawee. Must the acceptor pay according to his acceptance? Here the acceptor has not admitted the genuineness of the payee's indorsement and can refuse to pay the instrument on the ground that it belongs to B, C never having acquired title to the instrument because the indorsement was forged. The acceptor will thus have to pay the amount of the bill to B and not to C. So also, if a drawee pays a holder upon a forged indorsement, he can recover the sum so paid on the ground that he paid under mistake as to the genuineness of the indorsement.

The Transferor without Indorsement—A holder of a bearer instrument may negotiate the instrument by mere delivery, and no indorsement is necessary. Such a transferor, however, warrants and promises certain things. He promises that the instrument is genuine and in all respects what it purports to be. If the instrument is a forgery, his purchaser can hold him for breach of his warranty. He also promises that he has a good title to the instrument and that all the prior parties had capacity to contract. If, for instance, the bearer note is made by an infant and for this reason the holder fails to recover from the maker, the holder can recover from the transferor. Furthermore, the transferor promises that he has no knowledge of any fact which would impair the validity of the instrument or render it valueless. If the transferor knew that the maker of the instrument was bankrupt at the time of making, and for this reason the holder fails to recover from the maker, he can recover from the transferor. These warranties of the transferor do not extend beyond his immediate transferee. If his transferee negotiates the instrument to another party, that party, even though there actually was a breach of warranty by the first transferor, cannot recover from the first transferor for breach of the warranty.

The Qualified Indorser—It is commonly assumed that the indorser who indorses without recourse is not under any liability to his indorsee, but this is not the case. He makes the same warranties that the transferor without indorsement makes, and if the holder fails

to recover upon the instrument because of a breach of these warranties, he can hold the indorser without recourse. The only difference between the indorser without recourse and the transferor without indorsement is that the former's warranties run to all holders of the instrument subsequent to him, whereas the transferor's warranties run only to his immediate transferee.

The Indorser—The ordinary indorser warrants everything that the transferor without indorsement warrants. He also promises that if the instrument is not accepted or paid, or both, as the case may be, and that if the proper steps to notify him of this fact are taken by the holder, he will pay the amount of the instrument to the holder or to any subsequent indorser who has been compelled to pay the instrument. Thus the indorser, in a sense, guarantees that the instrument will be paid, but his liability is different from that of an ordinary guarantor in that it does not arise unless proper steps to notify him of the fact that the instrument has been dishonored are taken by the holder of the instrument.

Order of Indorsers' Liability—So far as the holder is concerned, all indorsers are equally liable to him. He can recover from any indorser or from all of them, but of course never more than the amount of the instrument. As between indorsers, they are liable to each other in the order in which they have indorsed the instrument, presumably the order in which their indorsements appear upon the instrument. Thus, if an

instrument is indorsed by B, C, and D, the holder can recover from any of the indorsers. Each indorser can hold any indorser prior to him but no indorser subsequent to him.

NOTICE AND PROTEST

Necessity for Notice—In order to charge parties secondarily liable upon a negotiable instrument, it is necessary that presentment be made and that notice of dishonor be given. Neither presentment nor notice is necessary to charge parties primarily liable. The parties primarily liable are the maker of a promissory note and the acceptor of a bill of exchange. These parties will be liable to the holder of a negotiable instrument without presentment or notice, but for all other parties, presentment and notice are necessary.

Nature of Presentment—Presentment may be for payment or merely for acceptance. Presentment means the exhibition of the instrument to the maker or to the drawee, as the case may be, with a request for acceptance or payment. It must be made on the day of maturity, which is the day specified in the case of time paper, and within a reasonable time after the date of issue in the case of demand paper. It must be made at the residence or ordinary place of business of the maker or drawee at a reasonable time of the day, or at such place as may be specified in the instrument itself. Delay in presentment is only excused where the circumstances responsible for the delay are not imputable to

the fault of the holder. A failure to make presentment as required operates to discharge all parties secondarily liable. In the case of a check, the rule is different. Here failure to present the check operates to discharge the drawer only to the extent to which such delay may actually have injured him.

Waiver of Presentment—It is not uncommon for indorsers to write after their indorsement the phrase "Notice and Presentment Waived." In such a case they will be held liable to the holder without any presentment or notice on his part. Such an express waiver of presentment may be given not only at the time of the indorsement but also at any subsequent time, either before or after the maturity of the instrument. Indeed, it is not necessary that the waiver be expressly given; it may be implied from the conduct of a party, as where due to his representations he induces the holder of the instrument not to make due presentment at maturity.

Notice of Dishonor—Not only must the holder make presentment in order to charge parties secondarily liable, but he must also notify them of the dishonor of the instrument. Unless such notice is given to them within the allowed time, they are discharged from liability. Although the notice of dishonor may be oral, it is usually written. It states the character of the dishonor and identifies by description the instrument dishonored. The Negotiable Instruments Law gives elaborate, detailed rules governing the place to which the notice should be sent and the time within which it

should be sent. Generally speaking, when the party to be notified lives in the same city as the holder, the notice must be sent so as to reach him before the close of business hours on the day following that upon which the instrument was dishonored. When the party to be notified lives in a different city, the notice must be sent so as to catch the next mail on the day following that of dishonor. If the notice is properly addressed and is sent by mail, its failure to reach the party to be notified becomes immaterial, for the law provides that properly depositing it in the mail is of itself the giving of notice.

Parties to Be Notified—The holder of a negotiable instrument may notify all parties or any party secondarily liable upon the instrument. If he is in doubt as to the financial responsibility of any particular person, he should notify any other person who may be secondarily liable. Any party notified may in turn notify any other party secondarily liable to him, and he has exactly the same time within which to give such party notice as the holder of the instrument originally had. Thus, if an instrument is indorsed by B, C, and D and the holder notifies D alone, D may notify C, and C may notify B. A proper notification given to another by a party secondarily liable inures to the benefit of the holder. Thus, in the case stated, C and B, having been properly notified by the immediately subsequent indorser, can be held by him and also by the holder. On the other hand, if D fails to give proper notice to C and C fails to give proper notice to B, the holder can charge only D. For this reason, it would be wise for the holder

to notify C and B in the first instance in addition to notifying D.

Protest—Protest is a written record made by a notary public of the fact that an instrument has been duly presented and dishonored. Its purpose is to provide the holder with an easy means of proving the facts concerning dishonor. The notary public, at the request of the holder, presents the instrument for acceptance or payment and upon dishonor makes out a record of this fact under his notarial seal and attaches it to the instrument. Protest is necessary to charge parties secondarily liable only in the case of foreign bills of exchange, but as it is such a convenient method of proving the facts concerning the dishonor of an instrument, it is commonly resorted to in cases of domestic bills of exchange and promissory notes as well. A foreign bill of exchange is a bill drawn in one jurisdiction and made payable in another. For this purpose the states of the Union are foreign to each other. Thus a bill drawn in New York and made payable in Massachusetts is just as much a foreign bill as one drawn in London and made payable in New York.

Dishonor by Non-Acceptance—Dishonor of a bill of exchange may be made by non-acceptance or by non-payment. Where a bill is presented for acceptance and acceptance is refused, the bill is then and there dishonored, and the holder must send notice of this dishonor to the parties secondarily liable if he wishes to charge them. He cannot wait and present the bill for

payment on the day of maturity and then, after receiving a second dishonor by non-payment, send notice of this second dishonor to the parties secondarily liable. Having been discharged through the failure of the holder to send a notice of the first dishonor, they remain discharged. If notice has been sent them after the dishonor by non-acceptance, the holder, if he wishes, may present the bill for payment in the hope that the drawee may have changed his mind. If the drawee still refuses payment, the holder need not give the parties secondarily liable notice of this second dishonor; their liability remains fixed by the notice of the first dishonor.

DISCHARGE

Payment as a Discharge—If an instrument is paid by the maker or drawer before maturity, the person who has received payment cannot again recover on the instrument even though he did not surrender the instrument at the time of the payment. Obviously, the law will not permit the same person to recover twice upon the same instrument. Suppose, however, that the holder who has received payment negotiates the instrument to C, who takes it in good faith and for value. Since C takes the instrument before maturity and without knowledge of any defect, he can claim as a holder in due course and can recover on the instrument from the maker. Payment before maturity is thus a personal and not a real defense, available only against persons who are not holders in due course. If the payment is made at or after maturity and the instrument is not sur-

rendered but is negotiated to X, X cannot recover upon it. Even though he took it in good faith and for value, he cannot claim as a holder in due course since he took it after maturity. There can be no holders in due course after maturity; hence payment on maturity operates as a real defense available against all holders of the instrument. Payment by the party primarily liable at or after maturity is a true discharge of the instrument.

Cancelation—The intentional cancelation of the instrument by the holder at any time operates to discharge it. Such cancelation is commonly done by mutilating the instrument in some fashion, such as by punching holes in it or by tearing it. Stamping it "Canceled" also operates as an intentional cancelation of the instrument. When the instrument is so canceled, no subsequent holder can possibly claim as a holder in due course since the instrument bears on its face marks to indicate that it is no longer a valid obligation. Cancelation is the common way in which the party primarily liable on the instrument prevents the instrument from again getting into circulation after it has been paid. An unintentional cancelation of the instrument does not operate to discharge it, for the holder can show that the cancelation was due to a mistake and so recover upon the instrument.

Discharge of Parties Secondarily Liable—Acts which operate to discharge the instrument also operate to discharge parties secondarily liable. An intentional cancelation of the signature of a party secondarily

liable, such as by drawing a line through an indorser's signature, also operates to discharge such a party. The discharge of a prior party operates to discharge any subsequent party also. Thus, if the indorsements on an instrument read "B, C, D" and the holder intentionally cancels B's signature, he also effectively discharges C and D. Any release of the principal debtor operates to discharge parties secondarily liable unless the holder expressly reserves his rights against them. Also any variation of the obligation of the party primarily liable, such as extending the time of payment, operates to discharge a party secondarily liable unless the holder expressly reserves his rights against the party secondarily liable. For this reason it is always wise, when the party primarily liable is released, to insert an express reservation of rights against all parties secondarily liable.

Renunciation by the Holder—The holder of a negotiable instrument may at any time expressly renounce in writing his rights against any party to the instrument. This renunciation, whether with or without consideration, will be given effect by the law. This is a peculiar rule of negotiable instruments and quite different from the ordinary rule of contracts which requires sufficient consideration in order to make a renunciation effective. Such a renunciation gives the party to whom the renunciation has been given only a personal defense. It will not be of avail to him against holders in due course.

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